



THE UNITED STATES OF AMERICA, DISTRICT COURT OF THE DISTRICT OF COLUMBIA, ss.  
I, the undersigned, Clerk of said Court, do hereby certify that the following is a true and correct copy of the original as the same appears in the records of said Court.

IN RE: THE ESTATE OF JAMES C. JAMES, JR., DECEASED.  
JAMES C. JAMES, JR., DECEASED, BY HIS EXECUTOR, JAMES C. JAMES, JR., ET AL.

THE NATIONAL BANK OF SAN FRANCISCO AND  
CALIFORNIA, DEPOSITORS OF THE ESTATE OF JAMES C. JAMES, JR., DECEASED, BY HIS EXECUTOR, JAMES C. JAMES, JR., ET AL.

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CERTIFICATE GRANTED APRIL 27, 1942



No. 9714

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**United States**  
**Circuit Court of Appeals**

**For the Ninth Circuit.**

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In the Matter of

THE WESTERN PACIFIC RAILROAD COMPANY, a corporation. Debtor.

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WESTERN PACIFIC RAILROAD CORPORATION, a corporation, THE WESTERN PACIFIC RAILROAD COMPANY, a corporation and IRVING TRUST COMPANY, a corporation, as substituted Trustee under the General and Refunding Mortgage of Western Pacific Railroad Company, A. C. JAMES CO., a corporation, THE RAILROAD CREDIT CORPORATION, a corporation,  
Appellants,

vs.

INSTITUTIONAL BONDHOLDERS COMMITTEE and  
RECONSTRUCTION FINANCE CORPORATION,  
Appellees.

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**Transcript of Record**

(Excluding Certain Portions not Printed, in Accordance with  
Stipulation and Order.)

In Six Volumes

**VOLUME II**

Page 471 to 962

Upon Appeals from the District Court of the United  
States for the Northern District of California,  
Southern Division.



## IX.

The Report Errs in Failing to Find That the Debtor's Plan Is Fair and Equitable and Otherwise Complies With the Provisions of Section 77 and Is Compatible With the Public Interest.

The Commission will recall the classic case of a Czar of all the Russias who indicated the route of a railroad between St. Petersburg and Moscow by a straight line ruled on a map between these ill-fated cities.

The railroad was not built on the Czar's route.

Barriers erected by nature may not have been insuperable but there were the vested moral rights of communities long established in territories tributary to the more natural lines of communication.

It is just as impracticable to attempt to reorganize rail carriers by "straight-line" methods and, as we have already pointed out such does not seem to be the underlying scheme and purpose of Section 77.

[463]

The most practicable approach to a reorganization must be along the normal line of least resistance and we shall now undertake briefly to show that the Plan promising the most hope (if not the only hope) of early accomplishment is the Debtor's modified Plan as summarized in the Report but with further modifications to meet certain views of the Bureau of Finance.

We submit, therefore, that the Report errs in failing at least to approve the basic principles of the Debtor's Plan.

It is to be here noted that the Debtor's original Plan was the Plan developed by leading members of the group representing First Mortgage Bondholders and in spite of their subsequent tactical defection we still think that a reorganization closely following the Debtor's Plan will command the support of sufficient First Mortgage Bonds to assure its success."

We shall therefore discuss in detail what we think would be an acceptable capital structure for the reorganized Company.

\$2,048,190. Equipment Trust Obligations and Baldwin Lease.

The assumption of these obligations by the reorganized Company is approved by all parties, is recommended by the Report; and no doubt will be acceptable to the Interstate Commerce Commission.

\$10,000,000.-\$19,858,000. 30 Year First Mortgage 4% Bonds.

The report limits the present issue of First Mortgage Bonds to \$10,000,000., the amount required for new money, and makes no allotment of new First [464] Mortgage Bonds to the holders of \$49,290,100. of the Debtor's present First Mortgage Bonds. The Debtor proposed that they be allotted 30% of their principal in new First Mortgage Bonds, involving a

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<sup>9</sup> Ex. 2—Outline Plan annexed to minutes of June 27, 1935. The background of the Debtor's Plan is shown at pages 4-9 of its Brief filed below.

fixed charge of only \$1,027,036, a reduction of approximately 66 $\frac{2}{3}$ %.

We have already stated the reasons why we think such a fixed charge is permissible and if the Commission also finds it permissible then 30% in new First Mortgage Bonds might properly be given the present holders of First Mortgage Bonds as an inducement to accept the composition. Inasmuch, however, as the Committee representing substantial holders of First Mortgage Bonds has itself proposed 20%, we think this ultra conservative allotment may prove a satisfactory compromise and ask that the Plan, as approved and reported by the Commission, provide for \$19,858,000. of First Mortgage Bonds, of which \$10,000,000. shall be for new money (or retirement of Trustees' Certificates) and \$9,858,000. for allotment to holders of \$49,290,100. of presently outstanding First Mortgage Bonds.

\$49,290,100.-\$39,432,100. 50 Year Income Mortgage  
4% Bonds.

The Report limits the issue of Income Bonds to \$19,716,140. and relegates the present First Mortgage Bondholders to a stock position in respect of approximately 60% of their principal debt. This, as we have already pointed out, is unduly harsh to the First Mortgage Bondholders, is required by no factor of public interest and tends to defeat a composition. Without repeating more of the prior discussion on this subject, we submit that a practicable Plan calls most [465] imperatively for the preserva-

tion of existing senior debt *as debt* and not as a mere equity and that \$39,432,100. of Income Bonds should be issued to holders of present First Mortgage Bonds, unless the Commission rejects our proposal to issue them 20% in new First Mortgage Bonds, in which event they should be given \$49,290,100. in Income Bonds, upon which they may reasonably expect a *full* return from the effective date of reorganization.

\$10,487,707. of 15 Year Collateral Income Notes.

Our more mature consideration of this reorganization in the light of the arguments of counsel and the discussions in the report leads us to the conclusion that a Collateral Note issue is the solution of the problem growing out of the present secured notes—a new issue of 15 Year Income Notes to be secured by \$18,999,500. of Prior Lien 4% Preferred Stock. The Collateral Notes should be in three series equally secured by the pledged collateral. Series A to be allotted to Reconstruction Finance Corporation, Series B to Railroad Credit Corporation, and Series C to A. C. James Co., with appropriate preference in the payment of interest to give recognition to their comparative collateral positions. Amortization should be provided on a sound basis.

\$9,503,664. of 4% Participating Preferred Stock for accrued interest to date of Reorganization.

There is a serious question whether *any* interest subsequent to the filing of the Petition under Sec-

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<sup>1</sup> Sexton v. Lloyd's Bank, Ltd., *supra*.

tion 77 is entitled to recognition.<sup>1</sup> It would be a liberal compromise of this [466] highly litigious issue to offer full interest up to the date of reorganization in a 4% Participating Preferred Stock (\$100. par value) consisting of 95,036 64/100ths shares amounting to \$9,503,664.

\$7,188,607. of 4% Convertible Preferred Stock for unsecured indebtedness.

To avoid any question as to the right of the unsecured creditors to a complete priority over the holders of the Debtor's Stock, the medium of settlement should be a 4% Convertible Preferred Stock (\$100. par value) junior to the Participating Preferred Stock issued in adjustment of claims for interest. We therefore propose that such Convertible Preferred Stock be issued at par to The Western Pacific Railroad Corporation and Western Realty Company in settlement of their unsecured indebtedness.

300,000 shares of No Par Value Common Stock.

The revised Plan of the Debtor proposes the issue of 300,000 shares of no par value stock.

We respectfully submit that this number of shares should be issued to The Western Pacific Railroad Corporation as sole holder of the Debtor's capital stock—the entire issue to be taken up upon the books at a valuation of \$1.00. If, as is indicated by the Report there is doubt as to its value, it will conform to sound accounting principles to enter the entire issue on the books at a valuation of \$1.00. *The public will*

*then be advised that the Common Stock is accorded no present day value but represents (a) voting power and, (b) the right to participate in possible future prosperity. [467]*

Assuming that the no par value stock is given a book value of \$1.00., the foregoing adjustments would provide the reorganized Company with the following simple, sound, financial structure:

Equipment Trust Obligations and Baldwin	
Locomotive Lease .....	\$ 2,048,190.
First Mortgage 30 Year 4% Bonds .....	19,858,000.
Income Mortgage 50 Year 4% Bonds .....	39,432,100.
Collateral Income Notes .....	10,487,707.
4% Participating Preferred Stock .....	9,503,664.
4% Convertible Preferred Stock .....	7,188,607.
Common Stock (Book Value) .....	1.
Total .....	\$88,518,269.

If, however, there is objection on the part of the Interstate Commerce Commission to a nominal value being placed upon no par value stock, then we suggest (but without waiving our contention that such a policy is wrong in principle and tends to destroy the usefulness of Section 77) that the proposed no par value stock be entered on the books at a substantial value. If this stock is entered at a value of \$100. a share, it will bring the total capital up to only \$118,518,269., which is an amount upon which a return may be earned in the immediate future but nevertheless is \$25,101,582. below the Commission's Section 19a valuation. If it is placed on the books at a valuation of \$50.00 a share, which is the present par value of the stocks of The

Pennsylvania Railroad Company and many other railroad companies, the total capitalization will be \$103,518,269., or \$40,101,582. less than the Commission's Section 19a valuation. If this is done the Plan "will conform to the requirements of the law of the land regarding the participation of various creditors [468] and stockholders", all of whom will be taken care of on a fair and equitable basis and should command sufficient support to make practicable the composition contemplated by Section 77.

Even in the days of ruthless mortgage foreclosures the stockholder was permitted to pay an assessment and stay in the situation. Section 77, like the Frazier-Lemke Act, the Home Loan Act, the various State enactments providing for suspension of foreclosure remedies, and a great mass of legislation, Federal and State, which came in the wake of the depression, was all for the protection and relief of the debtor and not for the aid of the creditors and we submit with all deference to the Bureau of Finance that the Commission should recognize this as the true spirit of Section 77.

Oral argument is hereby requested.

Respectfully submitted,

FRANK C. NICODEMUS, JR.,

Counsel, the Western Pacific  
Railroad Company.

15 Broad Street,

New York City.

Dated: September 27, 1937. [469]

## APPENDIX

The high function of the Interstate Commerce Commission is to approve a plan of reorganization compatible with the public interest designed to command the support of the percentages of each class of creditors and stockholders necessary to make a binding composition under Section 77 of the Bankruptcy Act which contemplates the relief and not the elimination of the debtor.

In *Continental Illinois Bank and Trust Company v. Chicago, Rock Island and Pacific Railway Company*, 294 U. S. 648, the Supreme Court, referring to the original Section 77, said:

"As outlined by that Section, a Plan of Reorganization, when confirmed, cannot be distinguished in principle from the composition with creditors authorized by the Act of 1867, as amended by the Act of 1874."

In the body of Section 73 of the Bankruptcy Act Congress declared that it was enacting Section 77 for the "relief of debtors." This unusual expressed declaration of the purpose of the Act was the most

This Appendix is a Section of the brief now being prepared by Frank C. Nicodemus, Jr. and William V. Hodges, as counsel for The Denver and Rio Grande Western Railroad Company, for filing in Finance Docket No. 11002 on October 1, 1937 and although subject to possible revision is here included in its original form for advance consideration by the Interstate Commerce Commission.

that Congress could do to prevent the defeat of its purpose and the avoidance of its objective in the course of administration through the interpretation and construction of any other language that might be found in the Act.

The plight of a railroad debtor under the applicable rules of law and equity as they existed before the enactment of Section 77 was that its creditors could take its property at a present-day depressed market value, determined by judicial sale and strip the Debtor of all value and interest not presently realizable on liquidation. If under Section 77 it is given similar treatment, its "loaf of bread" becomes a stone. It is twice mocked if, while relying upon Section 77, there is added to the creditor threat the political threat that its property is to be confiscated.

The relief which Congress offers the Debtor under Section 77 is predicated on the constitutional right of Congress to provide for *composition* under the bankruptcy power. Unless in its enactment Congress was evincing the lowest of legislative morals, it should not be contended that a law which depends for its life on the fact that it is an assertion of the constitutional power to authorize composition, really provides for the treatment of creditors or debtors in a manner repugnant to the principles of composition.

Long before Section 77 became law, men negotiated railroad reorganizations and sought the aid of

courts of equity to carry out their reorganization plans. Minorities had an effective power of obstruction, because they had in equity remedies which do not exist under composition principles.

Under equity practice much has been said by the courts about what is "fair and equitable" in a re-

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organization plan, which had to be said in the light of rights and remedies there under consideration. Much that has been so said has no application under Section 77, which contemplates the alteration of rights and a modification of remedies (Section 77 (b)).

One approach to the defeat of the declared intent and purpose of Section 77 is to insist on the application to the situation of the parties under that Act of all the language used by the courts in the discussion of what is "fair and equitable," but used with reference to the old rights and remedies.

The Debtor is familiar with the cases that are repeatedly cited on this question, and knows that they have been called to the attention of the Interstate Commerce Commission in many of the pending railroad reorganization cases. The Debtor is also familiar with the fact, not so often adverted to, that in the *Kansas City Terminal Railway* case (271 U. S. 445) the Supreme Court, attached qualifications to the test of "priority for priority," which is at the bottom of the other legalistic tests which are sometimes sought to be used as absolute measures of what is "fair and equitable" in a

corporate reorganization plan. All such tests are subject to qualification by the weight of a multitude of possible circumstances, so many circumstances that no rule for a test is so clear that it bars the way to a full consideration and weighing of all facts which bear upon the present-day value to the creditor of his existing claim and the value to him of what is offered in exchange.

Another road to the defeat in practice of the declared purpose of the Act would be to attempt under it [472] to exercise the power to extinguish anyone's interest in the Debtor's assets through administrative or judicial appraisal except in accordance with the principles of composition. Such a step would raise constitutional questions so serious that no self-respecting citizen would submit without exhausting his right of appeal to the highest authority.

Another course which leads beyond the safe boundaries of administrative and judicial jurisdiction under the Act would be the attempt to force upon any class of creditors or stockholders an adjustment in new securities to which the requisite majority of the interested class could not be expected within reason to give assent.

There are some who seek to locate the extreme boundaries of that jurisdiction beyond the constitutional danger point. It seems to the Debtor that it is much better to try through a practical course to make the Act useful and not jeopardize its usefulness by crowding beyond safe boundaries into areas of dubious power.

Before Section 77, when men representing various interests in a railroad property sought to reorganize and not dismember the property, they met around a table to agree upon a reorganization plan. Their first step was to engage in that field of business discussion and judgment where the real and important problems of give and take were solved. They functioned as reasonable and informed businessmen, each presumably intent on a "fair and equitable" adjustment of interests. Those judgments were far and away the most important steps in the process of arriving at a new [473] plan.

Their test of "fair and equitable," used in that area of discussion, was a business test. If the result of their efforts received the approval of a majority in interest of free and independent security holders, it was the best proof of the fairness of their efforts. Dissenting minorities could defeat those efforts by the application of legalistic tests of "fair and equitable"—quite different tests. Those tests were blocking the needed rehabilitation of railroad properties, and Congress substituted composition tests under bankruptcy powers.

Under the statute, that field of business judgment is now occupied by the Interstate Commerce Commission. If formerly aggressive selfishness tainted the formulations of reorganization plans, it is now eliminated. Furthermore, within the limits of Section 77, the Interstate Commerce Commission can see to it that any reorganization plans at birth conform to the public interest.

As intended by the Act, the Debtor has attempted to cooperate in a composition proposal to be made to all parties in interest under theegis of Interstate Commerce Commission approval. Until the Interstate Commerce Commission shall have proposed a Plan, the attitude of any class of security holders cannot be assumed. Fractions of various classes of creditors are represented before the Commission, but there is no one present to give an affirmative answer for the requisite majority, or a negative answer for a requisite minority. The Commission can and should do what could and should be done by reasonable and fair-minded men, representing the various interests in the Debtor's property toward evolving a Plan. [474]

The hope of the statute is that, in the first instance, the Commission can do the thing that reasonable men have been continually doing through this depression looking to the readjustment of debtor and creditor relations in all business areas.

If either through insistence on some assumed rights of creditors or because of some view of the public interest it is suggested that the Debtor be stripped, such a suggestion will be contrary to the purpose of the statute. If the existing priorities of interest in the property are not reasonably recognized, it will be contrary to the statute. But such priorities are not sanctified.

The decisions of the Federal Courts under the composition provisions of bankruptcy statutes hold

that an offer to creditors of a consideration equivalent to the present-day liquidating value of the Debtor's assets, leaving to the Debtor the hope of realization out of the unestimateable residue of value, is the proper basis for composition.

Cumberland Glass Co. v. DeWitt, 237 U. S. 447.

Nassau Smelting & Refining Works, Ltd. v. Brightwood Bronze Foundry Company, 265 U. S. 269.

In re Waynesboro Drug Co., 157 Fed. 101.

In re H. J. Arrington Co., 113 Fed. 498.

In re Realty Associates Securities Corp., 6 Fed. Supp. 549; 295 U. S. 295.

In the instant case the Debtor has suggested that creditors receive securities which represent not only any maximum appraisal of the present-day liquidating [475] value of the assets, but also a share in the future expectations of the property, which if realized will then give to the creditors a prior right to all the earnings that they would receive were the present-day securities to stand under a moratorium until that earning power is again reached.

As for the relief which Section 77 promises the Debtor, the Debtor suggests that it receive the common stock representing the residue of those values that cannot be estimated or liquidated today, and which the railroad as a going concern under present management and relationships has a promise of

realizing through the growth and development of the empire served by the Denver and Salt Lake Railroad, the development of business which must inevitably follow from the construction of the Cut-off and from the great expenditures for the betterment of the old lines made prior to the depression and being currently made by the Trustees.

The various classes of creditors and the stockholders of the Debtor, instead of locking horns at the threshold over problems of ultimate right, can, we submit, better serve the interests of all by endeavoring through the mechanics provided in Section 77 to reach a fair composition.

When the Plan goes to the Court it will be tested for conformity to composition principles and constitutional limitations. Unless there is an attempt to ignore composition principles or an attempt to confiscate the interests of some class of security or shareholders in the property, no constitutional objections need be expected.

[Endorsed]: Filed Oct. 5, 1939. [476]

Before the  
Interstate Commerce Commission  
Finance Docket No. 10913

In the Matter of  
The Western Pacific Railroad Company  
Reorganization

EXCEPTIONS OF IRVING TRUST COM-  
PANY, AS TRUSTEE, TO PROPOSED  
REPORT OF BUREAU OF FINANCE;  
AND BRIEF IN-SUPPORT OF SUCH EX-  
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## EXCEPTIONS

Irving Trust Company, as Trustee under General and Refunding Mortgage of The Western Pacific Railroad Company, dated as of January 1, 1932 (hereinafter termed the General Mortgage), hereby makes and presents the following exceptions to the Report proposed by the Bureau of Finance:

I. The Report errs in recommending (p. 51) that the Commission consider, for the purposes of a plan of reorganization, that the equipment covered by leases, conditional sale agreements or equipment trust agreements is subject to the lien of the First Mortgage in priority to the General Mortgage.

II. The Report errs in recommending (p. 50) that the Commission conclude that, in determining the equitability of plans of reorganization for the debtor, the lien of the General Mortgage on the Northern California extension and various branches and spurs in question is subject to the lien of the entire First Mortgage. [481]

III. The Report errs in recommending (p. 51) that the Commission also consider that the property characterized as non-carrier real estate, which was owned by the predecessor of the debtor, is covered by the First Mortgage in priority to the General Mortgage; and errs in not recommending that non-carrier real estate acquired after the date of the First Mortgage be considered by the Commission to be free from the lien thereof.

IV. The Report errs in its conclusion (p. 52)

that the creditors with whom are pledged General Mortgage bonds are not entitled to the same treatment as First Mortgage bondholders.

V. The Report errs in its conclusion (p. 56) that the provision made in the recommended plan for the participation of one of the unsecured creditors would not discriminate against either the First Mortgage bondholders or the General Mortgage bondholders.

VI. The Report errs in not recognizing that the creditors secured by the General Mortgage bonds are entitled to the benefit of the interest accrued on said bonds; and discriminates unfairly against such creditors in that the Report does recognize (p. 53) accrued interest upon the First Mortgage bonds.

VII. The plan recommended by the Report is unfair and inequitable to the holders of General Mortgage bonds and is contrary to the law of the land and the provisions of Section 77. [482]

### BRIEF

With a view to avoiding duplication, the General Mortgage Trustee confines this brief to the questions relating to relative priority of liens between the General Mortgage and the First Mortgage. Other questions which are raised by the Report, and which are of general interest to the security holders, such as the particulars of the securities to be issued, the power of the Commission to reduce the valuation of

the Debtor's property so drastically below the valuations made by the Commission for rate-making purposes, or the propriety of its action in so doing, are left for treatment by the interested parties.

## I.

The Report errs in recommending that the Commission consider, for the purposes of a Plan of Reorganization, that the equipment covered by leases, conditional sale agreements or equipment trust agreements is subject to the lien of the First Mortgage in priority to the General Mortgage.

In this respect the Report is most clearly and manifestly in error for the following reasons:

1. The First Mortgage expressly excepts such equipment unless acquired by the use of First Mortgage bonds or cash (First Mortgage, Exhibit 5, pp. 17, 21, 22); and the record shows that no First Mortgage bonds or cash were used in the acquisition of this equipment (see our brief dated January 11, 1937—hereinafter termed our original brief, p. 48).

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2. The First Mortgage omits the provision contained in the General Mortgage to the effect that when and as the Railroad Company acquires an equity in such equipment the equity becomes subject to the General Mortgage (see our original brief, pp. 50-51).

3. The Listing Application of December 21, 1931 (Exhibit 112), specifically states that such equip-

ment is not subject to the lien of the first Mortgage (see our original brief, p. 46).

4. The Report is directly contrary to the conclusions reached in the memorandum opinion of Circuit Judge Sanborn in *The Equitable Trust Company of New York, Trustee v. The Wabash Railroad Company, et al.*, U. S. District Court, Eastern District of Missouri, In Equity No. 3977; opinion filed November 7, 1921 (see our original brief, p. 52).

Our argument in respect of this equipment is set forth under Point III of our original brief, the general principles of construction being set forth under the heading "General" at pages 12-24. Specific comment appears to be required, however, in respect of the language in the First Mortgage, with reference to which the Report states as follows (p. 51):

"The latter paragraph reads as follows:

'Subject, however, as to all equipment now owned to the equipment trust or conditional sale agreements secured thereon, to the equipment trust or conditional sale agreements to which the same shall be subject as permitted hereby \* \* \*'

If all equipment acquired under equipment trusts was to be entirely free of the lien of the first mortgage, it is not understood why the words [484] "equipment trust or conditional sale agreements to which the same shall be subject as permitted hereby" were made part of

the last quoted provision. The Commission should consider, for the purposes of a plan of reorganization, that since the equipment in question was acquired for use, and was actually used, on the mortgage lines, the debtor's equity in that equipment is subject to the lien of the first mortgage."

The extract above quoted from the Report contains a typographical error in that it omits the language upon which the conclusion of the Report is based. The above-quoted language refers only to equipment "now owned", but the mortgage itself refers also to equipment "hereafter acquired". The correct language of the First Mortgage (Exhibit 5) is as follows (p. 22):

"Subject, however, as to all equipment now owned to the equipment trust or conditional sale agreements secured thereon and, as to equipment hereafter acquired, to the equipment trust or conditional sale agreements to which the same shall be subject as permitted hereby, and as to any property hereafter acquired by the Company or by any successor or purchasing corporation and becoming subject to the lien of this indenture, to any liens thereon existing at the time of such acquisition and not expressly prohibited by the terms of this indenture."

The Report does not quote the specific exception in the granting clauses of equipment acquired under lease, conditional sale or equipment trust (Exhibit

5, p. 22), nor is the exception mentioned in the summary of the First Mortgage contained in the Report (p. 49).

If the last-quoted provision were necessarily inconsistent with the immediately preceding and plain language (see Exhibit 5, p. 22) specifically excluding such equipment from the mortgage (unless acquired by First Mortgage bonds or cash), the last-quoted provision would have to give way. It is not contained in the granting clauses proper, but only in the "Subject, However", provision which follows the descriptions of the property granted. The Report erroneously permits the "Subject, However," clause to override the clear and controlling language of the granting clauses.

*American S. S. Co. v. Wickwire Spencer Steel Co.*, 42 F. (2d) 886, 893-94, aff'd 49 F. (2d) 766;

*Hernickell v. Omaha Water Co.*, 146 App. Div. (N. Y.) 693, 699;

*McKay v. Howard*, 6 Ont. 135, 137.

However, the language is not inconsistent. It is plain that the "Subject, However", clause with reference to thereafter-acquired equipment refers only to the possibility that equity in equipment, subject to equipment trust or conditional sale agreements, might be acquired by the use of First Mortgage bonds or moneys—in which case it might come under the First Mortgage by virtue of the provisions relating to the use of First Mortgage bonds or cash.

The First Mortgage (Exhibit 5) permits the use of First Mortgage bonds or cash for the acquisition of equipment (Article Second, Section 2, subsection A, clause (b), p. 41):

The documents required to be furnished as a basis for delivery of such bonds or cash are required to state (Exhibit 5, pp. 46-48) among other things whether the property acquired "is, or upon its acquisition will [486] become, subject to any lien or charge (within the meaning of the terms 'lien' and 'charge' as defined in subsection G of this Section 2) \* \* \*; and, if so, such certificate shall briefly describe such liens and charges and state the amount and character of indebtedness secured thereby, the due date thereof, the date of and parties to any indenture securing the same, and other particulars with respect thereto, and that sufficient First Mortgage Bonds or deposited cash remain available for reservation against such liens or charges as provided in subsection E of this Section 2."

Subsection E (pp. 57-58) provides for the reservation of bonds or cash equal to the amount of the "lien" or "charge" to which the acquired property is subject.

Subsection G (p. 60) then provides: "The words 'lien' and 'charge', as used in this Section 2, shall be deemed to include, among other things, deferred instalments of the purchase price of property in every case where title thereto has not then vested in the purchaser or, having so vested, is subject to a vendor's lien or any right of the seller to retake

or enforce a charge upon such property upon default in the payment of such deferred instalments of the purchase price and also the deferred payments to be made or rentals to be paid under any conditional sale agreement or lease or trust agreement covering equipment." (Italics supplied.)

It thus appears that the Report is completely in error in the vital conclusion that the equipment in question is subject to the First Mortgage because the "Subject, However" clause mentions a *particular species* of after-acquired property as covered by the mortgage although subject to equipment trust or conditional sale agreements to which the same shall be subject "*as permitted hereby*". The above quoted provisions from the [487] First Mortgage show that equipment is "permitted" to be subject to such agreements if First Mortgage bonds or cash are reserved in an amount equal to any such "lien" or "charge". The Report completely distorts the meaning of this limited provision in the "Subject, However" clause and permits it to destroy the clearly expressed intent of the mortgage that such after-acquired equipment shall not be covered thereby unless acquired by the use of First Mortgage bonds or cash.

In the present case, if First Mortgage bonds or moneys had been used to acquire the equity in question there would be presented a different question; but since it is clearly shown by the record (see our original brief, p. 48) that no First Mortgage bonds or moneys were used in the acquisition of the

equipment which we are considering, the question is not complicated; and we are left with a case coming indisputably within the specific mortgage provision that equipment acquired by "lease, conditional sale agreement or under any form of equipment trust" shall be "free from the lien hereof" "unless First Mortgage Bonds shall have been authenticated and delivered or their proceeds or other cash deposited hereunder paid out against the same\* \* \*," (First Mortgage, Exhibit 5, p. 22).

[488]

## II.

The Report errs in recommending that the Commission conclude that, in determining the equitability of Plans of Reorganization for the debtor, the lien of the General Mortgage on the Northern California extension and various branches and spurs in question is subject to the lien of the entire First Mortgage.

This recommendation is based upon a construction of the language of the First Mortgage as providing (Report, p. 49) that "the lien of the first mortgage attaches to after-acquired extensions if the purchase, acquisition or construction thereof, or any work thereon, be financed *in any part* with first mortgage bonds or cash deposited under that mortgage". (Italics added.)

Even this principle would not apply to the miscellaneous branches, aggregating some twenty-three miles, which were mentioned at pages 56 and 57 of

our original brief, nor to the certain tracks and spurs discussed in Point V of our original brief.

The Report is also in error in its statements concerning the execution of the General Mortgage, with reference to the lien on the Northern California Extension, and particularly in the statement (Report, p. 50) that "the general and refunding mortgage was not executed and delivered until several months after the completion of the extension." In fact the General Mortgage was executed and delivered on February 29, 1932 (Exhibit 6 p. 188), whereas the Northern California Extension was not completed for full operation until June 1, 1932, or later (Exhibit 56, p. 7), after further expenditures of [489] money obtained by the pledge of General Mortgage bonds (Exhibit 50, pp. 3-4; and see pp. 32-33 of our original brief).

A more far reaching objection to the conclusion which the Report recommends is that the language on which it relies does not support the proposed conclusion which is reached. The Report refers (p. 49) to subdivision marked Third (a) of the granting clause in the First Mortgage (Exhibit 5, p. 17), which covers after-acquired property and extensions if (1) they are "acquired or constructed by the use of First Mortgage Bonds or proceeds thereof or cash deposited hereunder," or if (2) "on account of the purchase, acquisition or construction thereof or work thereon, First Mortgage Bonds shall hereafter be authenticated and delivered or the proceeds of First Mortgage Bonds or other cash deposited here-

under shall hereafter be paid out under any of the provisions of this indenture."

The alternatives which the last quoted paragraph contemplates are either (1) the use of First Mortgage bonds or cash originally for the acquisition or construction of the property, or (2) their use as reimbursement for the cost of acquisition or construction. The words "on account" are not inserted in a manner to connote payments of only a part of the cost of construction, as the Report infers, or to indicate an intention to confer a complete lien in return for partial advances from First Mortgage funds, but rather serve to distinguish payments in reimbursement from original payments in anticipation of the acquisition or construction of new property.

If the meaning of the language quoted be regarded as open to any doubt, it should be resolved by a reasonable and equitable construction. In order to [490] demonstrate the inequity and practical absurdity of a construction which confers a first lien for the entire First Mortgage if *any* First Mortgage money is used, it is only necessary to suppose that the Railroad Company had acquired the Northern California extension at a cost of \$10,000,000 and had financed such acquisition to the extent of \$5,000 by means of First Mortgage bonds or cash. No court of equity would ever construe the mortgage so as to give to it a prior lien upon the extension beyond the amount of First Mortgage bonds and cash expended thereon.

The enforcement of a mortgage as against after-acquired property is wholly a matter of equity. (Guaranty Trust Co. v. New York & Queens County Railway Co., 253 N. Y. 190, 199; Hodder v. Kentucky & Great Eastern Railway Co., 7 Fed. 793, 799, aff'd sub nom. Wright v. Kentucky & Great Eastern Railway Co., 117 U. S. 72; Moulder Holcomb Co. v. Glasgow Coöperage Co., 173 Ky. 519, 522; Pomeroy's Equity Jurisprudence, Fourth Edition, Section 167.) Courts of equity apply the rule of strict construction to after-acquired property clauses in a mortgage and will not bring property within their purview unless the language imperatively demands. (See Cleveland Trust Co. v. Consolidated Gas, E. L. & P. Co., 55 F. (2nd) 211, 214, and other cases cited at pages 12-13 of our original brief.)

There can be no dividing line depending upon the amount of the expenditure. If the conclusion in the Report is correct, the same principle would necessarily control, no matter how trivial the expenditure, and how valuable the property, might be.

It is worthy of note also that (as is pointed out in our original brief, at pp. 35-37) it was never represented to the First Mortgage bondholders that their mortgage [491] would constitute an exclusive first lien upon the entire extension.

An equitable result would be reached by recognizing the prior lien of the First Mortgage to the extent of expenditures made from such bonds or cash, but only to such extent. The situation is very similar

in its equities to those which arose in the case of *Citizens' Savings & Trust Co. v. Cincinnati & Dayton Traction Co.*, 106 Ohio St. 577 (referred to in our original brief, at pp. 43-44). In that case it might have been held that the mortgage which was the earliest in date attached to the new power plant and that inasmuch as such mortgage was the earliest in date, it became the prior lien upon the entire new plant. Such a result, however, would have been inequitable, and the court worked out a manifestly fair and proper result by allowing to the earliest mortgage only its pro-rata lien. Similarly, in the present case, while no one would suggest that the First Mortgage lien should be cut down below the amount of expenditures, it would be equally inequitable to conclude that the entire First Mortgage lien attaches to this \$10,000,000 extension by virtue of the expenditure of less than \$5,000,000 thereupon. The only way by which the First Mortgage language in question can be so construed as to avoid gross unfairness is to construe it as meaning that the First Mortgage is the prior lien upon after-acquired property to the extent only of the First Mortgage bonds and cash used thereon.

Our arguments with respect to these properties are more fully set forth under Points II, IV, and V of our original brief. In the interest of economy of space, we refrain from repeating them here. [492]

## III

The Report errs in recommending that the Commission also consider that the property characterized as non-carrier real estate, which was owned by the predecessor of the debtor, is covered by the First Mortgage in priority to the General Mortgage; and errs in not recommending that non-carrier real estate acquired after the date of the First Mortgage be considered by the Commission to be free from the lien thereof.

In Point VI of our original brief, we urged to the Commission that specific property not subject to the lien of the First Mortgage included, among other things, (1) non-carrier property owned at the date of the First Mortgage (brief pp. 62, 63) and (2) subsequent additions to non-carrier property (brief pp. 63-69).

The Report mentions only the non-carrier property originally owned and recommends (p. 58), with respect to this, that the Commission conclude that such property is subject to the lien of the First Mortgage. This recommendation is stated to be based on the language of the First Mortgage, which the Report construes as not limited to railway property by the description of the First Mortgage bonds in the 1916 reorganization plan pursuant to which they were issued. That plan described the bonds as being secured by the "*existing railway properties*" (Rec. 584). Such a plan constituted a contract with the stockholders of the new Company.

as well as with the new bondholders (see our original brief, pp. 67-68), entitling them to consider that non-railway property would not be subject to the new First Mortgage. [493]

This Trustee, however, did not cite the 1916 plan solely for its contractual effect in limiting the lien of the First Mortgage, but as confirming the principle of legal interpretation that non-carrier real estate is not included in the security for a railroad mortgage unless specifically described, even though owned at the time the mortgage was created (see our original brief, pp. 65-69).

*After-acquired* non-carrier real estate is clearly free from the First Mortgage.

No argument in the Report, or in the Brief of the First Mortgage Trustees dated January 9, 1937, undertakes to justify extending the lien of the First Mortgage to *after-acquired* non-carrier property which was not financed by First Mortgage bonds or funds.

An analysis of Exhibit 114, and of Point VI of our original brief shows that the real estate owned prior to 1916 and now claimed by the First Mortgage Trustees amounted to \$2,165,615.48, book value; and that subsequently acquired non-carrier real estate, not financed under the First Mortgage, has a present book value of \$1,262,308.32. This represents a substantial item, which must be recognized as free from the First Mortgage even if the proposed Report be sound in respect of non-carrier property.

owned prior to 1916. No language in the First Mortgage will permit even a plausible argument that this property is covered by it. The existence of this substantial amount of real property not subject to the First Mortgage is particularly important in its bearing on the statement on page 52 of the proposed Report that the First Mortgage "should be considered as having a first lien on practically all the assets of the [494] debtor". That statement is in error even if the specific recommendations of the Report already discussed <sup>on page</sup> herein were sound.

#### IV

The Report errs in its conclusion that the creditors with whom are pledged General Mortgage bonds are not entitled to the same treatment as First Mortgage bondholders.

Under the plan recommended in the proposed Report (p. 53), the existing First Mortgage bondholders would receive all of the new income bonds, all of the new preferred stock and (as satisfaction of unpaid interest) approximately twenty-seven per cent. of the new common stock. The holders of General Mortgage bonds would receive only common stock, representing about forty per cent. of the total amount of common stock proposed to be issued.

Such completely subordinate treatment of the General Mortgage bondholders cannot be justified unless it be literally true (as the Report states, at p. 52) that the First Mortgage bondholders have "a first lien upon practically all of the assets of the

debtor." If there be *any* assets which are available to the General Mortgage bondholders in priority to the First Mortgage bondholders, the former must be given securities equal in priority to those received by the latter, to the extent of the assets on which the General Mortgage is a prior lien. These creditors, in fact, are as fully secured as are the holders of the First Mortgage bonds.

A plan which accords a completely subordinate position to creditors who hold a prior lien on even a sub- [495] stantial amount of assets does not, as required by Section 77(c), afford "due recognition to the rights of each class of creditors and stockholders."

Moreover, if the First Mortgage were to be foreclosed, the burden would be upon the First Mortgage Trustees to show what assets were subject to its lien, applying a strict construction of the after-acquired property clause, and excluding from the foreclosure sale all assets which were not subject to its lien. The Commission, in any proposed reorganization plan, cannot deny to the General Mortgage bondholders the rights of priority which they would have to be granted in a foreclosure of the First Mortgage.

Our original brief listed, at pages 9 and 10, assets free from the First Mortgage, and available to the General Mortgage bondholders, worth more than \$19,800,000. This is more than the total amount of outstanding General Mortgage bonds (\$18,999,500).

and over fifty per cent. more than the total amount of debt secured by such bonds, including interest (approximately \$11,770,582 as of January 1, 1937).

The proposed Report would eliminate, from the list of property available to the General Mortgage bondholders, the equity in rolling stock subject to lease or equipment trust agreement, the Northern California extension, and the real estate owned prior to 1916. These items, with the addition of the Deep Creek Railroad Company note and the Standard Realty & Development Company note as to which the General Mortgage lien is disputed, amount to approximately \$14,075,000, leaving approximately \$6,000,000 of property free from the lien of the First Mortgage, made up as follows: [496]

Cash in the hands of Trustee under General Mortgage .....	\$ 82,369.59
Interest on Tidewater Southern note paid to Railroad Company after default under General Mortgage .....	50,827.88
Additional interest accrued on Tidewater Southern note to December 31, 1936 .....	33,885.25
Note of Tidewater Southern Railway Company due March 1, 1945 .....	508,278.61
Stock of Tidewater Southern Railway Company (based on net assets at Interstate Commerce Commission values) .....	1,567,108.84
Bonds of Central California Traction Company .....	270,000.00
Non-carrier real estate after-acquired and not financed with First Mortgage funds (book value) .....	1,262,308.32
Cash on hand at date of institution of reorganization proceedings (adjusted by elimination of Tidewater Southern interest paid after default under General Mortgage) .....	\$10,331.39

Stock of Central California Traction Company (at book value to Western Pacific)	393,367.10
Alameda Belt Line stock (at book value to Western Pacific)	465,300.00
Industrial tracks, spurs, etc., representing in- vestment by Western Pacific of	239,663.04
Miscellaneous property acquired from free funds (at book value)	101,409.35
Various branches, 23.33 miles in length, not financed under First Mortgage	not valued
Total	<u>\$5,784,849.37</u>

It cannot be stated with any fairness that even the list of assets set forth above, which indisputably are security alone for the General Mortgage creditors (either as the holders of the General Mortgage lien or as the bulk of the unsecured creditors), are not sub- [497] stantial, in relation to the amount of debt secured by the General Mortgage. It should be emphasized, moreover, that the above reduced list is set forth only to show the situation if the recommendations in the proposed Report (which are clearly erroneous) were to be accepted.

The Report does not show the real value of most of the above-listed assets. For instance, while reciting (p. 18) the gross freight revenue of Tidewater Southern Railway Company, it omits to state that this important feeder, contributing traffic from which Southern Pacific Railroad derives approximately \$500,000 per year (Exhibit 27, statement No. 4; p. 2), earns a net income itself (after interest on the note held by the General Mortgage Trustee), of approximately \$75,000 per year (Exhibit 29, state-

ment Nos. 3-7, 28). No mention is made, among the analysis of subsidiaries (pp. 17-19), of the Central California Traction Company, although it is considered especially valuable as a feeder (Exhibit 82, p. 18; Rec. p. 164). The \$465,300 of stock of Alameda Belt Line pledged under the General Mortgage (see Exhibit 103) is not even mentioned in the Report's list of pledged collateral (p. 7). No consideration is given to the non-carrier real estate; nor to the free cash, amounting to over \$800,000, on hand when the reorganization proceeding was instituted, although this also is clearly free from the lien of the First Mortgage.

The various items listed above are discussed in more detail in our original brief.

Therefore, and even if (which is far from the case) the recommendations of the proposed Report, to which we except, should be accepted as correct, it is clear (from the amount of assets on which the General Mortgage is a prior lien as well as the smaller amount of [498] assets which are free both from the First Mortgage and the General Mortgage) that the creditors secured by General Mortgage bonds are entitled at least to upwards of forty per cent. of their debt in securities of the same type offered to the First Mortgage bondholders and should be treated, to such extent, as on a parity with the First Mortgage bondholders, rather than being completely subordinated to them. The failure of the Report to recognize this principle, as well as its fail-

are to find that the General Mortgage bondholders are fully secured, vitiate the entire Report.

V

The Report errs in its conclusion that the provision made in the recommended Plan for the participation of one of the unsecured creditors would not discriminate against either the First Mortgage bondholders or the General Mortgage bondholders.

The plan recommended in the proposed Report allocates \$10,000,000 par value of common stock to be issued as a bonus to the purchasers of the \$10,000,000 principal amount of new First Mortgage 4% bonds proposed to be issued. The first right to subscribe to such bonds, and to obtain such common stock bonus, is given to an unsecured creditor, which is also the principal stockholder. The result of the plan, if such unsecured creditor exercises its option, will be that it will receive practically the same amount of common stock which the General Mortgage bondholders receive. The plan of distribution of stock among the General Mortgage bondholders, as recommended in the proposed Report, would result [499] in certain of them receiving less than the face amount of their claims. Thus, while secured creditors are reduced to common stockholders with stock of par value less than the amount of their claims, one of the unsecured creditors would end up with stock of the same class, in an amount sub-

stantially equal to the total received by the General Mortgage creditors. Such a dilution of the securities offered to the creditors secured by General Mortgage bonds cannot be justified.

This Trustee has no information concerning the necessity for offering a \$1,000 bonus of common stock for every new \$1,000 bond. It doubts, however, that any stock bonus is necessary. At any rate, the determination of the amount of stock promised to be given should be based on the minimum necessary to provide a market, rather than on any theory (which the Report, at p. 54, apparently follows) that such bonus stock will recognize the claims of one of the unsecured creditors.

The pretense at recognition of the value of General Mortgage bonds is illusory. The securities which the holders would receive under the recommended plan are not only of much lower grade, but of less nominal value than the General Mortgage bonds which they replace. So long as this is true, and the holders of General Mortgage bonds are not paid in full at least the face value of their bonds, plus interest, it is improper to dilute their securities by handing out stock to one unsecured creditor.

Even if the value of new securities issued to the General Mortgage bondholders equalled the amount of their bonds, with accrued interest, a fair plan would still have to recognize their rights as general creditors for the amount by which any of their debts exceeded [500] the value of the new securities.

The total disregard of the portion of their debts which the recommended plan leaves unpaid, while offering them even less than the face amount of the bonds held as collateral to their debts, is indefensible.

The creditors secured by General Mortgage bonds now have a claim on the debtor's income and assets prior to any claim of the unsecured creditors. This priority of rank is a substantial right, which the reorganization plan cannot properly take away from them. Even a modified plan which would give to the creditors secured by General Mortgage bonds securities of a value equal to the bonds which they hold, must also provide, in order to be fair and equitable, that any stock offered to the unsecured creditor, as a bonus or otherwise be stock of a class inferior, as to dividend and liquidation rights, to the stock or other securities given in exchange for General Mortgage bonds. However, as has been stated, the General Mortgage bondholders are so fully secured that they should be given the same treatment as the First Mortgage bondholders.

## VI

The Report errs in not recognizing that the creditors secured by the General Mortgage bonds are entitled to the benefit of the interest accrued on said bonds; and discriminates unfairly against such creditors in that the Report does not recognize accrued interest upon the First Mortgage bonds.

The Report gives no recognition to the fact that

the General Mortgage bonds bear interest to which the pledgees are entitled after default. (See our original [501] brief, pp. 71-72.) The Report does recognize accrued interest upon the First Mortgage bonds, and recommends the issuance of common stock to them for the entire amount of the unpaid interest (pp. 52-53). This constitutes an unfair discrimination against the holders of the General Mortgage bonds.

## VII

The Plan recommended by the Report is unfair and inequitable to the holders of General Mortgage bonds and is contrary to the law of the land and the provisions of Section 77.

Some of the requirements of a reorganization plan are that it must (1) be "fair and equitable", (2) "afford due recognition to the rights of each class of creditors and stockholders", (3) "not discriminate unfairly in favor of any class of creditors or stockholders", and (4) "conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders" (Sec. 77(e)).

A plan is not fair and equitable if it does not afford due recognition to the rights of each class of creditors or if it discriminates unfairly in favor of any class of creditors or stockholders.

What has already been said above shows that the plan recommended in the proposed Report does not

afford due recognition to the rights of General Mortgage bondholders, and in fact takes no account of the substantial assets on which they have the prior lien.

What has been set forth in Point V shows also that the plan recommended in the proposed Report would discriminate unfairly in favor of one of the unsecured [502] creditors, and in effect place it on a parity with, or even on a higher plane than, the creditors secured by General Mortgage bonds.

A plan which has these effects does not "conform to the requirements of the law of the land."

The "law of the land" must have been meant by Congress to include the doctrine of the *Boyd* case (*Northern Pacific Railway Company v. Boyd*, 228 U. S. 482), that neither unsecured creditors nor stockholders can be given any participation in a reorganization until the prior rights of all senior creditors have been recognized. This principle is too well known to require elaboration. Recent cases which have applied the rule include *Security-First National Bank v. Rindge Land & Navigation Co.*, 85 F. (2d) 557 (CCA 9), disapproving a plan of reorganization which proposed a payment to bondholders of 40¢ on the dollar in full satisfaction, where the Court stated:

"The right to retain a lien until the debt secured thereby is paid is a substantive property right which may not be taken from the creditor consistently with the Fifth and Fourteenth Amendments to the Constitution" (p. 561);

and Horn v. Ross Island Sand & Gravel Co., 88 F. (2d) 64 (CCA 9).

The requirements of a fair reorganization plan were clearly set forth in the opinion of In re New York, New Haven & Hartford Railroad Company, 16 F. Supp. 504, 509, where the Court said:

"To be sure, under the act the court may approve a plan modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, etc. 11 U. S. C. A. §205 (b).

[503]

But since only an equitable plan may be approved, the plan must provide that every creditor in the order of his priority shall receive under the plan rights which in equity are the fair equivalent of such of his rights as have been subjected to equitable modification, at least in so far as the assets of the debtor's estate permit. Any creditor found to be only partially secured is entitled to the equitable equivalent of such security as he has, with a right to share in equality with common creditors for the excess of his claim as allowed above the value of his security as ascertained by equitable considerations."

The plan recommended does not meet the principles set forth in the foregoing opinion nor the requirements of the Act.

## VIII.

## CONCLUSION.

The recommendations of the Report with respect to the lien of the First Mortgage on equipment covered by leases, conditional sale agreements or equipment agreements, on the Northern California extension and various branches and spurs, and on non-carrier real estate, should be rejected. The Commission should find that these items are free from the First Mortgage, subject only to the lien thereof on the Northern California extension to the amount, and the amount only, of First Mortgage bonds or cash used in the acquisition or construction thereof.

The Commission should then allocate to the creditors secured by General Mortgage bonds their proper prorata of the same securities as shall be given to the holders of First Mortgage bonds. We have refrained [504] from discussing the details of the proposed capitalization and the nature of the securities which should be issued to the holders of the First Mortgage bonds and the General Mortgage bonds, because we believe that if the Commission shall find, as it should find, that the General Mortgage bonds are fully secured, further opportunity should be afforded for discussing, in the light of such finding, the treatment to be accorded to the General Mortgage bondholders.

Provision should also be made to prevent any possible dilution of the securities allotted to General Mortgage bondholders by securities offered to junior interests. This Trustee does not intend, by

anything which has been stated herein, to take sides as between the three creditors secured by General Mortgage bonds or even to discuss the comparative treatment which these creditors should receive.

*Oral argument is requested.*

Dated, New York, September 24, 1937.

Respectfully submitted,

DAVIES, AUERBACH & CORNELL,

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as Successor Trustee under General  
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ORRIN G. JUDD,

Of Counsel.

[Endorsed]: Filed Oct. 5, 1939. [505]

Before The  
Interstate Commerce Commission  
Finance Docket No. 10913

IN THE MATTER OF

THE WESTERN PACIFIC RAILROAD  
COMPANY REORGANIZATION

EXCEPTIONS OF A. C. JAMES CO., A SE-  
CURED CREDITOR, TO PROPOSED RE-  
PORT OF BUREAU OF FINANCE, AND  
BRIEF IN SUPPORT OF SUCH EXCEP-  
TIONS. [506]

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## EXCEPTIONS

A. C. James Co., a secured creditor of the Western Pacific Railroad Company in the principal amount of \$4,999,800, representing cash advances made to the carrier in 1931 and 1932 for the construction of the Northern California Extension, hereby excepts to the Report proposed herein by the Bureau of Finance, in the following respects:

1. The Report errs in its recommendation (Report, p. 46) that the capitalization of the reorganized company should be limited to \$91,406,510, principal or par value, of securities to be issued.

2. The Report errs in failing to give adequate weight, in its recommendations for the capitalization of the reorganized company, to the valuation of the properties of the company by the Interstate Commerce Commission; [509] under Section 19(a) of the Interstate Commerce Act, of \$144,619,851 (Report, p. 23).

3. The Report errs in recommending that the "allotment of the common stock to the secured creditors" (Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co.) "be made on the basis of the collateral held rather than on the amount of the claims" (Report, p. 54).

4. The Report errs in its recommendation that a capital fund be created out of available net income remaining after payment of fixed interest (Report, p. 41).

5. The Report errs in recommending that a sinking fund of one-half of one per cent be created and maintained for the retirement of proposed income bonds (Report, p. 42).

6. The Report errs in its recommendation that First Mortgage bondholders "should be considered as having a first lien upon practically all of the assets of the debtor" (Report, p. 52).

7. The Report errs in recommending that valuable rights be allotted to the Western Pacific Railroad Corporation (Report, p. 54) although it proposes to allot to A. C. James Co., on a claim amounting with interest to \$5,749,770, only \$2,643,320 par value of new common stock, or less than fifty per cent of the total amount of the claim.

8. The Report errs in recommending (Report, p. 55) that the Commission find that the equity of the preferred and common stockholder of the debtor is of no value.

9. The Report errs in failing to make provision for the claim of the Western Realty Company.

[510]

10. The Report errs in recommending (Report, p. 55) that any conditional rights under subscription warrants be allotted to the secured creditors in proportion to collateral held by them rather than in proportion to their actual advances.

11. The plan recommended is unfair and inequitable for its unjust discrimination against the A. C. James Co., is contrary to the law of the land and to the provisions of Section 77, and should be

modified in accordance with the recommendations hereinafter made.

## BRIEF

### General Statement

In certain respects the plan recommended by the Bureau of Finance for the reorganization of The Western Pacific Railroad Company is sound and forward looking. It fails, however, in vital respects, to take into account the actualities of the situation and disregards the intent of Section 77 of the Bankruptcy Act. The adoption of the proposed Report, without the modifications hereinafter indicated, will destroy existing possibility of a prompt reorganization of this carrier, consistent with the rights of interested parties and in accord with public interest.

The Western Pacific Railroad Company is, of all the more important carriers now in reorganization under Section 77, the one with the simplest capital structure, and the one most favorably situated to obtain the necessary consents of security holders. It is respectfully submitted that if sound principles are applied to the problem, The Western Pacific Railroad Company can be reorganized under Section 77, wisely and without further delay. [511]

In the following pages, we outline briefly the considerations which support the various exceptions stated above, and indicate those changes in the plan proposed by the Bureau of Finance which, if made, will render that plan an equitable and sound solution of the relations between the various classes

of security owners interested in the Western Pacific property.

Point I.

1. The Report errs in its recommendation (Report, p. 46) that the capitalization of the reorganized company should be limited to \$91,406,510, principal or par value, of securities to be issued.

2. The Report errs in failing to give adequate weight, in its recommendations for the capitalization of the reorganized company, to the valuation of the properties of the company by the Interstate Commerce Commission, under Section 19(a) of the Interstate Commerce Act, of \$144,619,851 (Report, p. 23).

The basic weakness of the plan suggested in the Report of the Bureau of Finance flows from the drastic and unnecessary limitation on capitalization which is suggested; namely, that the securities of the reorganized company shall not exceed an aggregate of \$91,406,510, including \$2,048,190 of assumed equipment trust obligations and \$10,000,000 of First Mortgage 4% Bonds, used for new money rather than to provide for existing creditors.

This proposed devaluation is surprising when one notes the statement in the Report that the company being reorganized held assets of a book value of \$171,- [512] 096,992.80, as of November 30, 1936 (Report, p. 6). These assets are now set off in the balance sheet of the company against capital liabilities, exclusive of accrued and unpaid interest, of \$145,276,379.26 (Report, p. 8).

Even more surprising is the suggested limitation in the light of the valuation of these assets as made by the Interstate Commerce Commission under Section 19(a) of the Interstate Commerce Act, adjusted to December 31, 1935, amounting to \$144,619,851 (Report, p. 23). Note also that this valuation figure is brought down only to December 31, 1935, and therefore does not include any increase in capital accounts due to the investment of new money under the current Improvement Program.

The suggested limitation on capitalization cannot be justified by any specific limitation within the four corners of Section 77. Subsection (b) (4) is the only definite limitation of capitalization in Section 77, and this limitation is solely as to securities which set up *fixed* charges. Under this provision of the Act, a plan to be approved by the Commission should contemplate that "there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof."

In the plan recommended by the Bureau of Finance the fixed charges are to be no more than the interest on equipment trusts amounting to \$86,473 (Report, p. 39), and the interest at 4% on such part of \$10,000,000 of First Mortgage Bonds, as may be issued for new money, which interest will not exceed \$400,000 per annum. Since the demonstrated adjusted net earnings available for interest even for 1936 amounted to \$1,766,632 (Report, p. 21), the provisions of Subsection (b) (4) of Section 77 are fully complied with. [513]

It is fair to ask this question:

“Why does the Bureau of Finance recommend such a radical limitation upon capitalization against the protests of all interested parties?”

When one reviews the Report in an endeavor to find an answer to this question, one does not find it squarely answered. The nearest approach to an answer is found on page 44 of the Report. There, after discussing the three plans submitted in this proceeding (one by the debtor company, one by a committee representing a group of institutions holding First Mortgage Bonds, and one by the A. C. James Co.), the Report makes the following statement:

“The debtor’s assets consisting of real and personal property have been described, and its investment in such property has been stated. While these data alone would seem to support the total capitalization proposed in each of the three plans. Yet when considered in connection with its record of earnings, it appears that the total capitalization of the reorganized company should be less than that proposed in any of the plans *if any material return in the future on the reorganized company’s capital stock is to be expected.*” (Italics ours.)

Certainly nothing in Section 77 of the Bankruptcy Act requires or authorizes a restriction upon capitalization to assure common stock dividends.

Apparently upon this tenuous basis the Bureau of Finance proposes to give to the A. C. James Co. only \$2,643,320 par value of common stock in liquidation of its secured claim, which arises from the actual advance of \$4,999,800 in cash during the years 1931 and 1932, to enable the debtor company to build its Northern [514] California Extension. This Northern California Extension is necessarily recognized to be, and has clearly demonstrated that it will continue to be, a highly important source of the earning power of the debtor company.

There is nothing clearer in our law than that in any reorganization proceeding creditors are entitled to insist that *fair values, and not forced sale values*, shall be used in determining the capitalization of the reorganized company and the securities to be given each class of creditors. A United States District Court in Michigan correctly stated the principle (*In Re Dutch Woodcraft Shops*, 14 Fed. Supp. 467, November 19, 1935) in the following language:

"Confirmation of the plan to revest the stockholders with title to the property of debtor would be justified only upon clear proof of fairness to creditors. Here the appraisal evidently was made on the basis of values which would be realized at a forced sale. Creditors may not be thus dealt with. In determination of the value of their claims, they are entitled to have recognized not only present liquidation values but also the prospective values of debtor's assets as a going concern."

See also *First National Bank of Cincinnati v. Flershem*, 290 U. S. 504.

If Section 77 is deemed impliedly to empower the Commission to so cut down capitalizations (in addition to the express power as to fixed charges), the Report of the Bureau of Finance does not point out the source of such power.

And conceding that a plan, to be in the public interest, "must provide a capital structure \* \* \* which [513] will give it a reasonable opportunity to function efficiently and continuously as a going concern" (Report, p. 36); it is not clear how the drastic and unnecessary scaling down of real values suggested in the Report is justified.

Nor is it enough to say that "the capitalization should not exceed a conservative valuation of the assets to be taken over by the reorganized company", for the question is, what is a conservative valuation? All the evidence in the record supports the Commission's lump sum valuation under Section 19(a) far better than it does the Bureau's theoretical devaluation to approximately ninety-one million dollars (and note that ten million dollars of this represents new money).

The Commission has dual powers and responsibilities. Its long existing powers over rates, and its responsibility to the public that reasonable rate structures be maintained, are necessarily ever present in the thinking of the Commission as to railroad problems. Yet elementary principles of due process of law and eminent domain should render the Commission alert to avoid any unreasonable and

confiscatory exercise of its powers over capitalization in reorganizations under Section 77 of the Bankruptcy Act.

Can the Bureau equitably sustain its recommended plan by any reference to "probable earning power"? When creditors are ready and willing to protect the carrier from future difficulties by accepting long term *income obligations*, no possible consideration of public policy requires the Commission to squeeze out of the picture honest debts, heretofore created under the supervision of the Commission, on the ground that unless this is done the *stockholders* of the reorganized company *may not* receive "any material return". [516]

In this case the record shows clearly that the probable earnings of the reorganized company justify a far greater capitalization than the Bureau of Finance here proposes.

Certainly the Commission ought not, as the Bureau of Finance would have it do, indulge in vague speculations as to whether an issue of income bonds maturing fifty years from now may then be refunded (if not previously converted into stock), or form a judgment as to whether, over the years, the holders of the proposed stock in the reorganized carrier will receive a "material return."

Even though the Report of the Bureau of Finance established a sound *theoretical* basis for its proposed drastic devaluation—and this it clearly does not do—nevertheless, the Commission ought not to approve such proposed devaluation. The Com-

mission has always had the difficult task of subjecting theories to the test of practical application. The problem of the Commission in this proceeding is to give to Section 77 of the Bankruptcy Act a practical application. No *theory* which defeats the legislative intent expressed in Section 77 should be adopted by the Commission for application in this proceeding, even though it may seem to present advantages from other points of view.

The test to be applied by the Commission in this proceeding has been well expressed by the Supreme Court in *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648, 676, as follows:

"\* \* \* But a proceeding under §77 is not an ordinary proceeding in bankruptcy. It is a special proceeding which seeks only to bring about a reorganization, if a satisfactory plan to that end can be devised. And to prevent the attainment of [517] that object is to defeat the very end the accomplishment of which was the sole aim of the section, and thereby to render its provisions futile."

If a plan embodying the drastic devaluation proposed by the Bureau of Finance were to be adopted by the Commission, (a) the purpose and intent of Congress that Section 77 of the Bankruptcy Act should provide machinery for the speedy reorganization of carriers which came into difficulties during the recent depression would be defeated; (b) the security owners interested in such carriers

would be thrown back to the prior practices of mortgage foreclosure and equity receivership, and (c) there would be substituted for the reorganization by negotiation contemplated by Section 77, reorganization by litigation, with all its attendant ills.

### Point II.

3. The Report errs in recommending that the "allotment of the common stock to the secured creditors" (Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co.) "be made on the basis of the collateral held rather than on the amount of the claims" (Report, p. 54).

A second vital defect in the proposed plan of the Bureau of Finance is one which especially discriminates against the A. C. James Co. as a secured creditor. This defect in the proposed plan flows directly from the recommended drastic devaluation of the assets of the carrier, which prevents the Bureau assigning obligations to the secured creditors in exchange for their existing claims. The Bureau of Finance suggests a plan which would deal with three secured creditors, all of whose [518] claims clearly belong in the same class\* under the doctrine of *Morgan v. Missouri Pacific Railroad Company* (U. S. Circuit Court of Appeals, 8th Cir-

\* The order of August 20, 1935, of the U. S. District Court in California, putting these claims, each in a separate class, was not upon notice to such creditors and was tentative and provisional, as to the propriety of such a classification.

cuit), 85 Fed. (2d) 351, by giving them common stock.

The Bureau has recommended that common stock can be provided for the Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co., consistently with the public interest as prescribed in Section 77 of the Bankruptcy Act, in the total amount, par value, of \$11,853,454.

The Bureau points out that this amount just equals "the total of the claims of the Reconstruction Finance Corporation, Railroad Credit Corporation, and A. C. James Company" (Report, p. 53).

It is further recommended that "the allotment of the common stock to these secured creditors be made on the basis of the collateral held rather than on the amount of the claims" (Report, p. 54).

The opinion of the Bureau setting forth the recommended allotment is as follows (Report, p. 54):

While, as stated, the par value of the stock available for distribution equals the principal and unpaid interest on the secured creditors' notes, the collateral pledged by the debtor as security for the notes is of varying amounts. For instance, the total of the Reconstruction Finance Corporation's claim is \$3,507,310 although it holds as pledgee 56.6 percent of the debtor's general mortgage bonds. The total claim of the Railroad Credit Corporation amounts to \$2,596,374 and 21.1 percent of the general mortgage bonds are pledged thereunder.

The total of the A. C. James [519] Company's claim amounts to \$5,749,770 and only 22.3 per cent of the general mortgage bonds are pledged thereunder. Under these circumstances it is recommended that the allotment of the common stock to these secured creditors be made on the basis of the collateral held rather than on the amount of the claims. Such allotment would result in the Reconstruction Finance Corporation receiving \$6,709,055 par value, the Railroad Credit Corporation \$2,501,079 par value, and the A. C. James Company \$2,643,320 par value of new common stock."

In short, the Bureau finds that common stock in the proposed reorganized company may be made available in an amount, par value, sufficient to pay in full the total loans of these creditors and interest thereon, but it is recommended that Reconstruction Finance Corporation, *with a claim of \$3,507,310 shall receive \$6,709,055* in stock in discharge of its debt; that The Railroad Credit Corporation, *with a claim of \$2,596,374, shall receive \$2,501,079* in discharge of its debt; and that A. C. James Co., *with a claim of \$5,749,770, shall receive \$2,643,320* in discharge of its debt.

A. C. James Co. excepts to this proposed allotment on the grounds that it ignores and repudiates the established equitable rights of the parties and that it is unfair and unduly discriminatory in favor of Reconstruction Finance Corporation and The Railroad Credit Corporation, at the expense of A.

C. James Co. contrary to the intent and purpose of Section 77 of the Bankruptcy Act.

A. C. James Co. maintains that the proposed common stock or any other securities in a reorganized company should be allotted to these three creditors pro rata according to the present value of their respective claims against the debtor. [520]

If an amount of common stock of par value equal to the "total of the claims" of these three creditors can lawfully be made available for them under Section 77:

(1) Why should the allotment of their respective shares of that stock be made "on the basis of the collateral held rather than on the amount of the claims"?

(2) If this amount of common stock can lawfully be made available to liquidate and discharge the "total of the claims" of these three creditors, as the proposed plan contemplates, why should it not be allotted *as a payment and discharge of each of their claims, rather than as a substitute for, or liquidation of, their respective holdings of collateral?*

#### Analysis of Reasons in Support of Recommended Allotment.

The Report does not undertake to answer the foregoing questions, nor to sustain the basis of the proposed allotment, other than as reference is made to the fact that "the collateral pledged by the debtor as security for the notes is of varying amounts" (Report, p. 54).

Apparently the Bureau has accepted the general thesis set forth by the Institutional Bondholders' Committee in its brief, dated January 9, 1937. The Committee's thesis is stated as follows:

"RFC, RCC, and ACJ are the holders of promissory notes of the Debtor for which there is pledged as the principal security in each case General and Refunding Mortgage Bonds of the Debtor. This collateral is held as between the three parties in entirely different ratios (Ex. 9). [521] The legal question is, whether their rights in the property of the Debtor are to be measured by the amount of the notes which they hold, or by the amounts of General and Refunding Mortgage Bonds held as collateral. It is clear that the latter is the true test, subject only to the limitation that no one of the claimants may realize a present value in excess of the total amount due on its claim for principal and accrued interest." (p. 64).

No authorities involving proceedings under or outside the Bankruptcy Act are cited in support of this "true test."

It is further set forth in the foregoing brief that:

"The pledge of the Debtor's mortgage obligations to secure a promissory note of course creates but one 'debt' viz. the note. But the effect of the pledge is to vest in the holder of the note an interest in the mortgage securing

the pledged obligations equal to that proportion of the whole value of the mortgaged property which the amount of pledged mortgaged [sic] obligations bears to the total amount of obligations outstanding under the mortgage. Obviously, if a debtor has outstanding two notes each for \$10,000, one secured by \$10,000 of the debtor's mortgage bonds and the other secured by \$90,000 of the debtor's mortgage bonds, both out of a total issue of \$100,000 of such bonds, the security of the second noteholder in the debtor's assets is nine times that of the first note holder. This is subject to the limitation that in realization upon his interest in the mortgage the second noteholder must not receive more than the amount due on the note itself.

"Thus in equity proceedings, it has become settled law that noteholders in the position of RFC, RCC and ACJ in this case are entitled upon the sale of the Debtor's property to realize [522] directly upon the pledged securities without having first reduced them to possession and to receive distribution on the basis of face value of their collateral." (pp. 65-66)

Five cases (p. 66) are cited at the conclusion of this last paragraph. We fail to find how they support the "true test."

It will be observed that the foregoing statements nowhere particularize *how or when*, under existing law, the right of these pledgee-creditors *to realize*

*upon their collateral mortgage bonds according to their respective holdings of those bonds, is reconciled with "the limitation that in the realization" no one "may realize a present value in excess of the total amount due on its claim for principal and accrued interest."*

Such particularization, when made according to established rules of equity, will show that, on the facts of this case at least, these pledgee-creditors should share in the proposed common stock according to the present value of their respective claims, and not according to their respective bond holdings. (By the term "present value" of a claim is meant the amount of the principal loan, plus interest accrued thereon, pursuant to the terms of the loan agreement to the date of confirmation of the plan by the judge without compounding interest.)

#### The Equitable Rights of the Three Pledgee-Creditors

It seems unquestionable that, in proceedings under Section 77 of the Bankruptcy Act, established rules of equity fixing the relative rights of the parties in interest should be accorded full credit. This is true because courts of bankruptcy "are essentially courts of equity, and their proceedings inherently proceedings in equity," [523] *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648, 675 (1934) (proceedings under Section 77 of the Bankruptcy Act), and because the Act conditions the judge's jurisdiction to approve any plan of reorganization upon

his being satisfied that it is "*fair and equitable*" (Section 77 (e) (1)).

Stated as a *broad generalization*, it may be conceded as an elementary rule of equity that where two or more creditors are secured by pledge of unequal amounts of bonds which in turn are secured by the same mortgage, and the bonds are of equal priority under the mortgage, the pledgees may, as between themselves, share in the net proceeds of the foreclosure sale according to the face value of their bonds. *But this rule of equity is of consequence as a rule of distribution only if and when a deficiency in the mortgage security has been realized so that all of the pledgee-creditors holding the mortgage bonds will not be paid therefrom their principal and interest in full.*

We emphasize this particularization of the foregoing elementary equity rule of distribution because the record of these proceedings nowhere discloses, nor has it been contended, that the mortgage security is or has been inadequate to pay in full the present value of the claims of the three pledgee-creditors. This same particularization likewise reconciles the alleged "true test" set out in the brief of the Bondholders' Committee (quoted *supra*) with the limitation that no one of the claimants shall receive more than the principal of his claim with interest.

There appears to be no dissent in the authorities that the debtor's General and Refunding Mortgage could not be foreclosed for a greater sum than the aggregate present value of the pledgees'

claims (aggregate principal with interest thereon pursuant to the respective loan agreements to date of the foreclosure decree). This was decided by Brewer, J., in the notable case of *Simmons v. Taylor, et al.* (Circuit Court, S. D. Iowa, C. D. 1885), 23 Fed. 849, 857, as follows:

“One further question requires notice. Obviously most, if not all, of the bonds secured by this second mortgage were issued as collateral security for certain debts of the mortgagor. *Should such bonds today be treated as valid obligations for their face and interest, or as binding only to the extent of the debts secured thereby? I think the latter.* Take the bonds held by the Lackawanna Iron Company, for instance. They were given as a collateral security only, and the present holder took them under such circumstances as to charge him with notice. *Instead of being a debt for their face, all that the present property should be held liable for is the amount of the debt due to the iron company secured by these bonds.* So in respect to others.

“The order therefore should be that the matters be referred to the master of this court, to state—*First*, which of those bonds secured by this second mortgage were issued simply as collateral security for debts of the mortgagor; *second*, the present value of the debts secured thereby, and *third*, if any of those bonds have been transferred from the holders of such debts,

under what circumstances, and for what consideration they passed to the present holders. *Upon the coming in of such report of the master, and finding of the amount which is properly secured by this second mortgage, a decree will be entered directing the sale of the mortgaged property within 60 days to pay such amount.* (Italics ours.) [525]

As we have stated, this ruling appears to have the unanimous approval of the authorities.

Accord:

Newport & Cincinnati Bridge Co. v. Douglass, trustee, 12 Bush (Ky.) 673, 720 (1877) (Foreclosure proceedings with receivership in aid. "Some of the bonds issued under the later mortgages are in pledge to certain of the company's creditors. These bonds should be paid to the extent necessary to satisfy the debts for which they are held as collateral security, and no more.").

Jessup, et al. v. City Bank of Racine, et al., 14 Wis. 331, 340 (1861) (Foreclosure proceedings).

Baxter v. Washburn, 8 Lea (Tenn.) 1, 17 (1881) (Foreclosure proceedings).

Nelson v. Hubbard, 96 Ala. 238, 254 (1891-1892) (Foreclosure and statutory proceedings for dissolution and liquidation of mortgagor corporation).

Peacock v. Phillips, et al., 247 Ill. 467, 93 N. E. 415 (1910) (Foreclosure proceedings).

Kelly et al. v. Wellsburg, Etc., Co., 74 W. Va. 130, 140, 81 S. E. 712 (1914) (Foreclosure proceedings).

See, also, *Equitable Trust Co. of New York v. Great Shoshone & Twin Falls Water Power Co., et al.* (D. Ct. D. Idaho, S. D. 1915), 228 Fed. 516.

It necessarily follows from the foregoing authorities that parties entitled to redeem the mortgaged property may do so by paying no more than the present value of the debt owed to pledgees like Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co. *Simmons v. Taylor, et al., supra.*

It may also be pointed out in passing, that there is substantial authority holding that while a pledgee of mortgage bonds may sue at law upon the collateral [526] bonds (rather than upon his principal note) as the personal obligation of the debtor-mortgagor, judgment will be allowed only in sufficient amount to pay the debt and interest due thereon. *Murphy v. Murphy*, 74 Conn. 198 (1901). And, of course, in insolvency proceedings, the pledgee may prove and have allowed against the debtor's *general estate* his principal-debt only and not his collateral bonds. *Hitner, et al. v. Diamond State Steel Co.* (Circuit Court, D. Delaware, 1910), 176 Fed. 384.

The rule of distribution *in case of a deficiency* was neatly and precisely applied in the recent case of *First Nat. Bank of Ottawa v. Kay Bee Co., et al.*, 366 Ill. 202, 7 N. E. (2d) 860 (1937).

The case came before the Supreme Court of Illinois upon appeal from a judgment affirming a decree of foreclosure. The mortgagor corporation had executed a deed of trust mortgage to the plaintiff

to secure \$50,000, which was represented by two bonds, each in the principal sum of \$25,000 of equal priority, and bearing interest at the rate of 6%. One bond was pledged with the Ottawa bank as collateral security for loans which totaled at foreclosure \$24,000 (not including unpaid interest). The other bond was pledged with the Morrison Bank as collateral security for loans which totaled at foreclosure \$16,500 (not including interest). To quote the Court (pp. 860, 861):

“\* \* \* On March 20, 1936, a decree of foreclosure was entered by the circuit court of Whiteside County. The decree found there was due the Ottawa bank, \$24,956.20, for which it held as collateral security bond No. 1, and due the Morrison Bank, \$17,117.25 for which it held as collateral security bond No. 2. The mortgaged premises were directed to be sold to satisfy the indebtedness. The decree further provided that *if the sum [527] should be insufficient to pay the several amounts due the respective banks, then the master should distribute the fund in the proportion that the sum due each bank bore to the total amount due both banks.*” (Italics ours.)

The Morrison Bank appealed from the provision of the decree relating to distribution in event of a deficiency; taking the position that, in event of deficiency, the proceeds of the foreclosure sale “should be prorated between the banks on the basis of the proportion which the bond held by each bore to the total amount of the bonds issued.”

The Supreme Court reversed the lower court, and held (p. 861):

"\* \* \* The rule applicable is, that the two banks, as the holders of the several bonds pledged to them respectively as surety for the primary indebtedness of each, should share in the funds derived from the sale of the mortgaged property, until the primary indebtedness is satisfied, on the basis of the bond held, and not on the factor of the aggregate debt owing the banks."

The court set forth the rationale of its ruling as follows (p. 861):

"The purpose of a pledge is to give the creditor additional security out of which payment of the primary debt may be made. In the case at bar the bonds, secured by the trust deed stood on the same plane. When they were pledged, each bank, *for the purpose of further protection to its primary debt*, owned one-half of the security furnished by the trust deed. By the sale of the property under the foreclosure of the trust deed, the funds derived are substituted for the real estate. By the conversion of the property into money through sale under the foreclosure, the security [528] afforded by the bonds pledged to the respective banks, did not shift so that the funds should be distributed on the basis of the debt due each bank bore to the total of the primary debts due

the two banks. So to hold would, in practical effect, give the bond held by the creditor to whom there was due the larger debt, a preference over the creditor to whom the lesser amount was due. The application of a different rule would result in a variable and shifting factor in the value and extent of the security granted the creditor to whom had been pledged a portion of a series of corporate bonds, the value varying in accordance with the amount of primary indebtedness held by other creditors holding like hypothecated bonds as collateral security therefor." (Italics ours.)

We do not challenge the foregoing decision nor the authorities which are in accord. We emphasize only that the decision expressly concerned a decree involving the distribution of the proceeds of a foreclosure sale, if, and when, a deficiency were realized.

Relying upon the foregoing authorities, we reiterate that it is the established equity law of the land that the allotment of common stock to Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co. should be according to the present value of their respective claims, unless and until it is shown that there is a deficiency in the value of the mortgage security. Only in case of such deficiency might they realize upon the security according to the face value of their collateral bond holdings. Absent such deficiency the pledgees' relative interests in the mortgage security exist ac-

ording to the present value of their respective claims.

The record in this case makes no pretense at showing, nor has it been contended, that the security back of the [529] debtor's General and Refunding Mortgage Bonds has been, or is, insufficient to pay in full the present value of the debts owed to Reconstruction Finance Corporation, The Railroad Credit Corporation, and A. C. James Co.

It is conceded that the General and Refunding Mortgage is secured by all of the assets of the debtor's system except cash and current assets derived from free funds; that it covers assets of substantial value which are not subject to the First Mortgage; and that the extent and scope of the First Mortgage as a lien prior to the General and Refunding Mortgage are challenged by the Trustee of the latter mortgage.

In order not to engage at this point in the challenge of the scope and extent of the lien of the First Mortgage as made by the Trustee of the General and Refunding Mortgage, we will assume its priority and restate our point, set forth in the last preceding paragraph, *supra*, as follows: Nothing in the record of these proceedings shows, nor has it been contended, that the property of the debtor subject to its two mortgages is, or would be, insufficient upon foreclosure or other judicial sale, to liquidate and pay in full the present value of the genuine debt secured by the respective mortgages:

The First Mortgage indebtedness, with interest thereon to January 1, 1937, has been reported as \$57,504,866

The debt secured by the General and Refunding Mortgage (notes held by Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co., with interest thereon to January 1, 1937), has been reported as 11,853,454

Total \$69,358,326

[530]

The Bureau has set forth in the Report (pp. 22-23) that the debtor's system was valued as of December 31, 1935, for rate making purposes, in the total amount of \$144,619,851.00.

Book value of road and equipment investments alone was reported in the Trustee's balance sheet of November 30, 1936, at \$139,371,768.08 (Report, p. 6).

The Bureau has further found that even on its drastic basis of proposed reorganization, the assets and probable earnings warrant a capitalization of \$91,406,510 (including the \$10,000,000 "new money" for expenditures under the Rehabilitation Program), (Report, p. 46.)

Note further that the issue of all the outstanding First Mortgage Bonds of the carrier, and all of the General and Refunding Mortgage Bonds held by the secured creditors, was approved by the Commission, and that the last such order of approval, which brought the authorized General and Refunding Mortgage Bonds to a total of \$18,000,000 was

made February 25, 1933. In other words, that order, which confirmed the existing debt structure of the carrier, was made approximately at the end of the recent depression, and since that time we have had five years of recovery.

In view of these considerations, and in view of the absence of any judicial sale in these proceedings, we submit that it is beyond challenge that the security behind the carrier's General and Refunding Mortgage is and has been sufficient to liquidate and pay in full the total claims due Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co. And, to repeat, this conclusion is derived without relying upon the challenge by the Trustee of the General and Refunding Mortgage of the scope and extent of the First Mortgage as a prior lien. [531]

#### Further Equitable Rights Which Are Unlawfully Denied by the Recommended Plan

The recommended allotment also ignores and repudiates the rights of subrogation and exoneration of A. C. James Co. to have The Railroad Credit Corporation reimburse itself under its junior lien on the excess collateral held by Reconstruction Finance Corporation, and restore the \$2,000,000 of bonds which A. C. James Co. loaned to The Railroad Credit Corporation, thereby obviating the deficiency of collateral bonds held by A. C. James Co. It is also apparent that the right of A. C. James Co. to the restitution of its \$2,000,000 bonds loaned to The Railroad Credit Corporation is further sup-

ported by the equitable rule of marshalling which requires that a creditor holding two securities shall, when it can be done without prejudice to him, exhaust one of his security funds in aid of another creditor who has a claim on only one of the security funds. *Merrill v. National Bank of Jacksonville*, 173 U. S. 131, 140 (1899). This is especially important in this case because of the excess collateral held by the Reconstruction Finance Corporation for its secured loan.

The Proposed Common Stock Is Not a Mere Substitute or Exchange for the Existing Collateral Security

As we have pointed out before, the Bureau utters no explanation in support of its recommended allotment of the common stock in the reorganized company.

We have also pointed out how the proposed allotment ignores and repudiates the existing equitable rights of the parties as established by courts of equity, including the rights of subrogation, exoneration and marshalling of A. C. James Co. [532]

Speculation upon a possible support for the allotment has prompted the thought that possibly it was predicated upon the hypothesis that the new stock will be distributed as *a substitute and exchange for the collateral security which the pledgee-creditors now hold* and that, therefore, they should be awarded proportional ownership in the substitute according to their holdings in the original collateral rather than according to their claims as creditors.

This would be extraordinary principle indeed.

*Any such rule would necessarily rest upon an assumption that these creditors were entitled to trace their collateral bond holdings into the new stock without any regard for the principles of equity or law under which the collateral bonds were held for purposes of security only; that they were subject to redemption; that they were subject to rules at law and in equity precluding the creditors from collecting more than the amounts due them respectively; and subject to the equitable rights of The Railroad Credit Corporation as a junior lienor of the collateral bonds held by Reconstruction Finance Corporation, and subject to the equities of subrogation, exoneration and marshalling inhering in A. C. James Co. with respect to the security.*

Nothing in Section 77, nor elsewhere in the Bankruptcy Act, authorizes a plan of reorganization to reclassify and transform creditors holding collateral security into co-owners of a substitute for their collateral security and then require them to share their ownership in the substitute according to the ratio of their prior collateral security holdings.

Traditional it is that Section 77 was amended into the Bankruptcy Act as a debtor relief measure to provide ways and means of scaling down and extending [533] the time of payment of debts of railroad corporations. The Bureau recommends in its Report that, under Section 77, the capitalization of the reorganized company should be scaled down and altered so that the fixed charges of the company

shall be adequately covered by the probable earnings available therefor, and the plan as a whole shall be compatible with the public interest (Report, p. 36).

To comply with the intent and purpose of Section 77 it is unquestionable that the new common stock must have been proposed for the three pledge-creditors as a *payment and discharge of their present claims as creditors*. This is further manifest from the provisions of Section 77 concerning the function and effect of a plan of reorganization. If the plan is confirmed by the judge, Subsection (f) of Section 77 provides that "the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon the debtor, all stockholders thereof, \* \* \* and all creditors secured or unsecured \* \* \*. Upon confirmation of the plan \* \* \* property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan \* \* \*." Everyone realizes that the proposed common stock is not made available as a continuing or substitute security for any debt which will continue to be owed to these creditors; its one and sole function under [534] the

plan would be to pay and discharge their several claims. It should be allotted accordingly.

There is no authority in Section 77, nor elsewhere, whereby the proposed common stock provided for the three pledgee-creditors shall be allowed to serve a series of functions, namely, first, as a substitution and exchange for the creditors' present collateral holdings and, second, as a payment and discharge of their claims. *But if there were authority under Section 77 to treat the proposed stock as a substitute and exchange for the original security, rules of fairness and equity are yet to be conceived which would sustain the recommended allotment. As has been pointed out, there is no deficiency in the original security held by these pledgee-creditors. No principle of law or equity justifies assuming one for purposes of allotting the "substitute collateral."* Such assumption would be no more warranted in law or equity than is the allotment. Finally, there is, of course, no principle of fairness or equity to support any suggestion that the proposal to give this common stock to these creditors of itself establishes any deficiency in the original security held by them.

These same considerations would apply with the same force against the proposed allotment, if the common stock were conceived as being offered in "payment" or "liquidation" of the creditors' *original collateral holdings* rather than as a substitution or exchange therefor. Under the principles of law and equity set forth above, the relative rights of these creditors are derived through their claims

against the debtor and according to their present value. Absent a deficiency in their original security, there is no equity or law to justify the creation of new and discriminatory rights in what may be offered as a "payment" or "liquidation" of that security. [535].

Any plan which does not recognize the advances made by the three junior creditors as equal in equity, all having been made during the depression years to preserve the existence of the carrier would be inequitable and discriminatory as to the A. C. James Co. If there is a distinction as between these junior creditors, arising from the application of the funds advanced, it is in favor of the A. C. James Co., since its advances were used for the construction of the Northern California extension, now an important element in the earning power of the carrier property, while the advances of the Reconstruction Finance Corporation and The Railroad Credit Corporation largely went into the pockets of the First Mortgage bondholders, either by paying them unearned interest, or by paying current tax charges prior in lien to the First Mortgage Bonds.

### Point III

4. The Report errs in its recommendation that a capital fund be created out of available net income remaining after payment of fixed interest (Report, p. 41).

In addition to the difficulties of fair apportionment of interest between the different classes of creditors which flow from the drastic limitation on

capitalization recommended by the Bureau of Finance, the Report adds additional difficulties by recommending a deduction up to \$500,000 a year from the effective income of the carrier to provide for future capital additions.

The language of the Report (pp. 40-41) in which this recommendation is made is as follows: [536]

"Since new first mortgage bonds would not be issued in principal amount to exceed 75 percent of future capital expenditures, the balance of such expenditures must be financed through the issue of junior securities or from earnings. Under both the debtor's plan and the bondholders' plan funds for such expenditures would be secured from the hereinbefore described capital fund contemplated by their plans. *While the A. C. James Company opposes the creation of such a fund, as well as a sinking fund for the redemption of bonds, it does not contend such funds are not in accordance with the principles of sound financing, but that the Revenue Act of 1936 places too great a penalty on the retention of earnings for such purposes.* It is essential, however, that the reorganized company should not be embarrassed in securing funds for future capital expenditures. \* \* \* It is recommended, therefore, that the plan approved by the Commission provide for the creation of a capital fund out of available net income remaining after payment of fixed interest. To avoid too heavy a sacrifice by present security

holders, payments into the fund should not exceed \$500,000 in any one year, nor, in any event, the sum needed to raise the totals of the fund to \$1,000,000 at any time, and payment into the fund should be dependent upon earnings and noncumulative." (Italics ours.)

In the above statement, the fact that the debtor's plan and the bondholders' plan each provided for a capital fund should be read with the qualification that each of these plans, as the record in this proceeding clearly indicates, was prepared in the interest of the institutional holders of First Mortgage Bonds and by the same draftsman. The rights of other creditors of the carrier were not given fair consideration in providing such a [537] drain upon the earnings of the company with a priority over the interests of all other creditors.

As to the intimation that the A. C. James Co. conceded that a capital fund from current earnings was in accordance with the principles of sound financing and only barred by the present Federal Revenue Act limitations, it is obvious that the position of this creditor was not clearly understood by the Bureau of Finance.

A. C. James Co. opposed and opposes, for basic reasons, the creation of such a capital fund from current earnings. It maintains that a deduction of \$500,000 a year from the current earnings of the reorganized carrier immediately after fixed charges is unnecessary, violates modern principles of sound

corporate financing, imposes upon the carrier an unreasonable tax burden under the Federal Revenue Act, and is prejudicial to the equitable rights of all existing creditors of the carrier.

Is the current deduction of \$500,000 a year for capital expenditures necessary, as is intimated by the language of the Report set out above? In so far as capital expenditures represent replacements, the moneys are provided from income by reason of the operation of the depreciation deductions prescribed by the Interstate Commerce Commission. To say that any further moneys are required to replace capital assets which must be retired for obsolescence or otherwise is to suggest that depreciation provisions of the Uniform System of Accounting prescribed by the Interstate Commerce Commission are inadequate and unsound.

Consider next new additions of fixed capital.

We submit that it is a far more wholesome situation for a carrier to be compelled to come before the Commission and ask for authority for the issue of the necessary capital securities, whether bonds or stock, than for the carrier to be left free to plow back into the property moneys obtained from the shippers. Investment in such additions is not warranted until after earnings have covered operating expenses and a fair return on the existing capital.

If a sound capital structure is constituted, there is no reason why the necessary funds for any proper extension, approved by the Interstate Commerce

Commission, cannot be obtained through properly balanced senior and junior financing. It is a reasonable limitation that 25% of such capital funds should be derived from sources other than First Mortgage Bonds. *It is, however, an unreasonable requirement that 25% of such future capital expenditures should be derived from funds withheld from those creditors of the carrier who advanced money for its prior capital expenditures.* So long as capital additions to the property of the carrier are obtained through the issue of new capital securities, the Interstate Commerce Commission retains full control of such additions. If on the other hand, the Commission should attempt to force a compulsory investment of money, which ought to go to the existing creditors of the carrier on account of their prior investment, that would seem to be clearly confiscatory action by the Commission, and as such, unreasonable.

Nor is it true that such deductions from current income for capital expenditures (or for sinking funds on bond issues, hereinafter discussed) are recognized as being in accordance with the principles of sound corporate financing. Even before the Federal Revenue Acts included a legislative declaration condemning the policy of retaining undistributed current earnings, through reinvestment or otherwise, it had become apparent that [539] provisions in corporate mortgages for deductions from current income for capital purposes or for the retirement of bonds did far more harm than good.

We cannot but recognize that the Interstate Commerce Commission has forcibly urged upon Congress that the existing provisions of the Revenue Act which penalize the retention of current earnings by corporations, including railroad, should not have application to the railroads of the country. The Commission, however, must recognize as a practical matter that its representations to Congress have had no effect, and that the Federal Revenue Act does still penalize such retention of capital funds. A compulsory redemption ought, therefore, to be imposed upon a carrier, only upon a clear showing of necessity.

Take the situation we are here considering: Suppose the reorganized carrier were to earn only the interest on its equipment trusts, \$86,473 (Report, p. 39), and the interest on ten million dollars of First Mortgage Bonds of \$400,000, plus \$500,000 which it was compelled to plow back into the property under the suggested capital fund provisions of the Bureau of Finance. Actually, it would not be able to plow back \$500,000, because in retaining such moneys, it would impose upon itself a liability to pay \$161,202.80 in Federal income taxes on such retained income.

If the somewhat unduly pessimistic view of the Bureau of Finance as to future earnings of this carrier should prove to have any basis, the unreasonableness of a provision for \$500,000 per year

deduction from income for new capital expenditures becomes obvious. *Why should the management of the carrier be allowed or required to spend \$500,000 a year from current income [540] for future capital additions, while the creditors of the carrier, who have furnished the money to build the present property, stand aside and wait upon such additional investment for any return upon their moneys?* Why should the principal claims of existing creditors be scaled down in deference to such inequitable charge upon future earnings? Obviously, the proposed charge could be justified only if it were shown to be essential to the preservation of the property as a going concern. If the depreciation reserve policies promulgated by the Interstate Commerce Commission are sound, as the Bureau should assume they are, there can be no necessity for \$500,000 per annum of additional capital expenditures to preserve the property.

Any plan which contemplates a deduction from the earnings of the reorganized carrier, after fixed charges, for the purpose of capital investment, is unsound and inequitable.

#### Point IV

5. The Report errs in recommending that a sinking fund of one-half of one per cent be created and maintained for the retirement of proposed income bonds (Report, p. 42).

In the Report of the Bureau of Finance, after a discussion of the proposed \$500,000 per year capital fund, it is stated (Report, pp. 41-42):

“ \* \* \* It also is believed to be desirable that provision be made at least for the retirement of the income bonds. \* \* \*

“ \* \* \* It is recommended, therefore, that provision should be made in the plan approved by [541] the Commission for the creation and maintenance of a sinking fund of one-half of 1 percent to be used for the retirement of income bonds hereafter recommended out of available net income remaining after the payment of fixed charges, payment into the capital fund, and interest on income bonds.”

In discussing this recommendation of the Bureau of Finance, we will point out at the outset that we are not here concerned with a proposed sinking fund for an issue of bonds which will be sold to the public and which, in the judgment of the Bureau of Finance, should contain provisions assuring retirement within the period of the issue. The proposed sinking fund applies only to income bonds proposed to be issued to existing creditors of the carrier. The money of these creditors is now frozen into the carrier property. None of these creditors is asking that it be permitted to withdraw it. What everyone is trying to do in this proceeding is to assure the creditors of the carrier that their relative claims will be recognized on a fair basis, consistent with the continuance of the carrier as a going concern, and that future income will be fairly apportioned among them. The Commission, therefore, may well omit a sinking fund from these income bonds

without abandoning the position which it has taken in the past as to the desirability of sinking funds in connection with the issue of new capital obligations.

We reiterate, moreover, that, owing to unfortunate experiences with the operation of sinking funds on corporate obligations during the depression years, and a realization of the heavy burden imposed upon such moneys retained from income to retire capital obligations through the operation of the Federal Revenue Acts, the [542] use of sinking funds is being largely abandoned in connection with the issue of corporate obligations, except where such obligations are supported by wasting assets, as in the case of mining companies, oil companies, and similar operations.

Take one instance from the electrical industry, which is in some respects closely comparable to the railroad industry: In the years 1935, 1936 and 1937, one group of gas and electric companies in Greater New York issued capital obligations in the aggregate principal amount of \$235,000,000. These issues were approved by the Public Service Commission of the State of New York, registered with the Securities and Exchange Commission, and sold to the general public by banking houses. The issuing companies, the amount of each issue, and the maturity of each issue were as follows:

Name of issuer	Amount of issue	Date of maturity
Consolidated Edison Company of New York, Inc.	35,000,000	Apr. 1, 1946
Consolidated Edison Company of New York, Inc.	35,000,000	Apr. 1, 1956
The New York Edison Company, Inc.	55,000,000	Oct. 1, 1965
The New York Edison Company, Inc.	30,000,000	Apr. 1, 1966
Brooklyn Edison Company, Inc.	55,000,000	May 15, 1966
New York and Queens Electric Light and Power Company	25,000,000	Nov. 1, 1965

In no one of the indentures supporting the above issues was there any provision for a sinking fund for the retirement of these obligations before maturity.

If the income bonds which the Bureau of Finance proposes shall be issued for a part of the existing debt [543] owed First Mortgage bondholders of this carrier were to be ten year bonds or twenty year bonds, some provision for retirement might fairly be considered. Here, however, the proposed income bonds are fifty year bonds. Not for a half century will the carrier face the problem of refunding the obligation. If it be thought that we ought now to plan for that refunding, quite obviously it can better be done by including a conversion privilege which at some time in the fifty years is likely to make it advantageous to exchange such income bonds for preferred or common stock without fixed maturity, rather than by a compulsory deduction from current income which penalizes the company

in additional Federal income taxes, and unnecessarily and inequitably penalizes existing creditors of the carrier with like effect as the proposed capital fund considered in Point III above.

It would appear that in the existing situation, the creation of a sinking fund from current income to retire the income bonds is unnecessary and prejudicial, and should not be incorporated in a plan approved by the Commission.

#### Point V

6. The Report errs in its recommendation that First Mortgage bondholders "should be considered as having a first lien upon practically all of the assets of the debtor" (Report, p. 52).

This recommendation in the Report is clearly contrary to the facts which appear on the face of the Report itself. Leaving out of account the persuasive showing made by the Trustee of the General and Refunding [544] Mortgage Bonds as to substantial items of physical property upon which that mortgage is asserted to be a lien, at least *pari passu* with the First Mortgage, it is undisputed that the General and Refunding Mortgage is a prior lien on property of substantial value. Moreover, the First Mortgage cannot, on any possible theory, be regarded as any lien on current assets, stated on page 7 of the Report, to amount to \$7,653,809.28, including \$3,290,601.55 in cash.

During the hearings before the Bureau of Finance, the position of the A. C. James Co., as a

secured creditor of the carrier, was stated to be one of unwillingness to concede that the First Mortgage bondholders had, as their counsel asserted broadly but failed to prove, a first lien upon practically all of the assets of the debtor, but as willing to concede, as a part of a fair plan of reorganization (and in the plan submitted on behalf of the A. C. James Co., it was so provided) that there should be a definite subordination of other creditors to the First Mortgage bondholders, even as to assets upon which the other creditors may now have (through holding General and Refunding Mortgage Bonds as collateral) a first lien, as an offset to certain necessary concessions on the part of the First Mortgage bondholders. This continues to be the position of this creditor. [545]

#### Point VI

7. The Report errs in recommending that valuable rights be allotted to the Western Pacific Railroad Corporation (Report, p. 54) although it proposes to allot to A. C. James Co., on a claim amounting with interest to \$5,749,770, only \$2,643,320 par value of new common stock, or less than fifty per cent of the total amount of the claim.

It is perhaps sufficient to state in connection with this exception that if the A. C. James Co. were to be given for a claim of \$5,749,770, only \$2,643,320 par value of new common stock, it would clearly be

a general creditor for upwards of \$3,000,000; and entitled, as such, to share in any distribution to general creditors of the carrier in any sort of proceeding:

Nor can there be any doubt in the minds of anyone familiar with this situation and with the existing situation as to general interest rates, that the right which it is proposed to give to the Western Pacific Railroad Corporation as a general creditor, to buy 4% First Mortgage Bonds at their face value, with the issue presently limited to \$10,000,000, and secured by a first lien upon a property fairly valued at approximately fifteen times that amount, with a bonus of \$1,000 of common stock for each \$1,000 bond, is a valuable right. On no possible theory can such a right be allocated to the Western Pacific Railroad Corporation while the claim of the A. C. James Co. remains unsatisfied to the extent of more than one-half its amount. [546]

#### Point VII.

8. The Report errs in recommending. (Report, p. 55) that the Commission find that the equity of the preferred and common stockholder of the debtor is of no value.

The factors involved in this exception have been sufficiently discussed in Point I above. It seems unnecessary to do more than to repeat here that an attempt on the part of the Bureau of Finance to solve the problem of reorganization proceeding un-

der Section 77 by asking the Commission to squeeze out in such a proceeding about one-half of the value which it heretofore found the carrier to have for rate-making purposes, in order to eliminate the preferred and common stockholders, is unsound and confiscatory beyond justification in law or equity.

### Point VIII.

9. The Report errs in failing to make provision for the claim of the Western Realty Company.

Some reference has been made above to various instances of the sweeping way in which the Bureau of Finance proposes to brush aside vested equitable and legal rights without any showing of public right or interest. Its treatment of the claim of the Western Realty Company is a further example. The Western Realty Company is a creditor of the carrier in the principal amount of \$50,000, which debt ranks on a parity with the debt owed to the Western Pacific Railroad Cor- [547] poration. The Bureau of Finance proposes to give the Western Pacific Railroad Corporation valuable rights in exchange for its claim, but gives nothing to the Western Realty Company, unless paragraph 10 on page 60 of the Report applies, and the debt to the Western Realty Company is to be paid by the reorganized company, as an obligation of the debtor not specifically provided for. As a matter of fact, whether or not the record discloses it, the stock of Western Realty Company has been pledged to one of the

creditors of Western Pacific Railroad Corporation, and its rights cannot be so completely ignored.

### Point IX.

10. The Report errs in recommending (Report, p. 55) that any conditional rights under subscription warrants be allotted to the secured creditors in proportion to collateral held by them rather than in proportion to their actual advances.

There has heretofore been a sufficient discussion of the principle here involved, under Point II. above. Obviously, any conditional rights under subscription warrants which were allotted to the secured creditors could not properly be allotted in proportion to the collateral held by them, but must be allotted instead according to the present value of their claims upon confirmation of the plan by the judge. [548]

### Point X.

11. The plan recommended is unfair and inequitable for its unjust discrimination against the A. C. James Co., is contrary to the law of the land and to the provisions of Section 77, and should be modified in accordance with the recommendations hereinafter made.

It is possible that other creditors of this carrier will protest broadly against the suggestion of the Bureau of Finance that the Interstate Commerce

Commission should itself propose a plan which differs so radically from the plans submitted by interested parties. In any such broad protest A. C. James Co. will not join. This creditor conceives it to be the right and duty of the Commission under Section 77 so to proceed; *provided the plan so proposed is fair and equitable*, and is motivated by a desire to find a sound ground upon which the minds of the interested parties may meet, rather than by a desire to effect unnecessary and drastic changes in the capital structure of the carrier, for reasons not related to the solution of its present difficulties.

This creditor believes, moreover, that if the plan proposed by the Bureau of Finance were to be modified in the respects indicated below and approved by the Commission, it would be likely to receive the necessary approval of at least two-thirds of each class of creditors.

The changes indicated, however, are, in the opinion of this creditor, the minimum changes necessary to secure a practical, fair and equitable plan and to make possible a speedy reorganization of this carrier under the provisions of Section 77. [549]

#### Proposed Amendments to Bureau of Finance Plan.

For the reasons set out above, it is respectfully urged that the Interstate Commerce Commission modify the plan proposed by the Bureau of Finance, in the respects specified below:

1. By increasing the issue of Fifty Year Income Mortgage 4% Bonds from the proposed principal

amount of \$19,716,040 to \$49,290,100; that is, to an amount sufficient to refund the entire principal amount of the outstanding First Mortgage Bonds of the carrier.

2. By authorizing an issue of \$10,445,018 of Sixty Year 4% Convertible Income Debentures to refund the principal amounts owed Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co., convertible into preferred stock on the basis of fifteen shares of such preferred stock for each \$1,000 Convertible Income Debentures.

3. By reducing the amount of the proposed Non-Cumulative 5% Preferred Stock from \$29,574,060 par value, to \$25,290,729, of which \$9,623,202 would be immediately issued to fund the interest claims of the existing First Mortgage bondholders and of Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co., and \$15,667,527 reserved in the treasury of the reorganized company to meet the expected conversion of the Convertible Debentures given to the secured creditors for the principal of their debt. (Here, as elsewhere in this brief, the amounts of interest stated in the Report as of December 31, 1936, are used.)

[550]

4. By eliminating from the proposed plan of the Bureau of Finance any provision for deductions from current income for capital expenditures or for a sinking fund on the income bonds.

If the above-suggested modifications in the plan proposed by the Bureau of Finance were to be adopted by the Commission, the reorganized company would issue (a) \$10,000,000 (or such part thereof as might be necessary to secure the new money required for the Rehabilitation Program) of its new Thirty Year Mortgage 4% Bonds; (b) \$49,290,100 principal amount of Fifty Year Income Mortgage 4% Bonds to the First Mortgage bondholders for the principal of their debt; (c) \$10,445,018 in Sixty Year 4% Convertible Income Debentures to Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co., to represent the principal of their claims, allocated so as to refund their respective principal claims in full; (d) \$9,623,202 par value of Non-Cumulative 5% preferred Stock (or so much thereof as may be necessary) for the unpaid interest which has accumulated on the First Mortgage Bonds and on the claims of Reconstruction Finance Corporation, The Railroad Credit Corporation and A. C. James Co.; (e) \$5,807,650 of Common Stock to the Western Pacific Railroad Corporation and to the Western Realty Company, in satisfaction of their claims (principal only), for unsecured advances; (f) \$10,000,000 of the Common Stock as a pro rata bonus with such new First Mortgage Bonds as are issued; (g) the balance of the Common Stock to be allocated to the Western Pacific Railroad Corporation in recognition of the inter-

est which it has as sole stockholder in the carrier.

[551]

After these steps were taken, the capital structure of the new company (prior to any conversion of income debentures) would appear as follows:

Undisturbed Equipment Trusts, Baldwin Lease and Pullman Contract .....	\$ 2,048,190
New Thirty Year First Mortgage 4% Bonds .....	10,000,000
Fifty Year Income Mortgage 4% Bonds .....	49,299,100
Sixty Year 4% Convertible Income Debentures .....	10,445,018
5% Non-Cumulative Preferred Stock .....	9,623,202
Common Stock .....	30,068,220
Total .....	\$111,474,730

Against the above capital obligations which would be outstanding, there would be assets valued by the Interstate Commerce Commission under Section 19(a) of the Interstate Commerce Act, at \$145,000,000 as of December 31, 1935, and this prior to any increase in such assets which may result from the application of the proposed \$10,000,000 of new money invested under the Rehabilitation Program.

In Conclusion, A. C. James Co. respectfully urges upon the Interstate Commerce Commission that it modify the plan proposed by the Bureau of Finance so as to make possible a prompt and equitable readjustment of the capital structure of this carrier as a demonstration of the effectiveness of the machinery provided by Congress to that end, in the provisions of Section 77 of [552] the Bankruptcy Act. And A. C. James Co. respectfully asks that it

be granted an oral hearing before the Commission on the matters herein discussed.

Respectfully submitted,

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[Endorsed]: Filed Oct. 5, 1939. [553]

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Before the

Interstate Commerce Commission.

Finance Docket No. 10913.

THE WESTERN PACIFIC RAILROAD COMPANY REORGANIZATION.

EXCEPTIONS OF CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO AND SAMUEL ARMSTRONG, AS TRUSTEES UNDER THE WESTERN PACIFIC RAILROAD COMPANY FIRST MORTGAGE DATED JUNE 26, 1916, TO PROPOSED REPORT OF BUREAU OF FINANCE, AND BRIEF IN SUPPORT OF SUCH EXCEPTIONS. [554]

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**EXCEPTIONS.**

1. The Report errs in recommending (pages 53 and 59) that new common stock be allotted on a dollar for dollar basis to the holders of existing First Mortgage Bonds in respect of the unpaid interest on said bonds and in not recommending the allotment in respect of such interest of securities ranking prior to the securities allotted to the junior secured creditors.

2. The Report errs in recommending (pages 53-54 and page 60) that the junior secured creditors be allotted securities ranking equally with the securities allotted in respect of the unpaid interest on the existing First Mortgage Bonds.

3. The Report errs in recommending (pages 41 and [556] 43) that interest on the new income mortgage bonds should be non-cumulative, payable only out of available net income determined on the basis of six months' income periods ending June 30 and December 31 in each year.

4. The Report errs in not recommending the allotment of new first mortgage bonds to the holders of existing First Mortgage Bonds in respect of at least a portion of their claims.

5. The Report errs in recommending (pages 52 and 59) that a bonus of 10 shares of new common stock be given to the purchaser of each \$1,000 principal amount of new first mortgage bonds and in recommending (pages 54, 55 and 60) that The Western Pacific Railroad Corporation and the

junior secured creditors be given preferential rights to purchase such bonds at par and to receive such bonus in common stock.

6. The Report errs in its conclusion (page 56) that "The provision for the participation of the unsecured creditor would not discriminate against \* \* \* the first mortgage bondholders \* \* \* because such unsecured creditor must contribute \$1,000 in cash for each new \$1,000 bond and 10 shares of new common stock received."

7. The Report errs in its conclusion (page 56) that, if the new securities are allocated as recommended in the Report, "it would result in preserving the priority [557] of the first mortgage bondholders as to the principal amount of their bonds over all other existing creditors and stockholders in so far as new securities are available."

8. The Report errs in recommending (page 61) "that the Commission find that the plan as recommended herein will meet with the requirements of subsections (b) and (e) of section 77 of the Bankruptcy Act, and will be compatible with the public interest."

## BRIEF.

### I.

#### Introductory Statement.

Section 77 of the Bankruptcy Act requires, among other things, that any plan approved by the Commission pursuant to subsection (d) of that section shall be "fair and equitable," shall afford

"due recognition to the rights of each class of creditors and stockholders," shall "not discriminate unfairly in favor of any class of creditors or stockholders," and shall "conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders" (subsection (e) of Section 77).

The Report states (pages 46-47) with reference to the provisions of subsection (e): [558]

"The language comprising those provisions has long had a settled meaning in equity reorganizations. Briefly stated it is to the effect that no plan of reorganization will be fair and equitable if it attempts to secure the rights and interests of stockholders at the expense of the prior rights of secured or unsecured creditors. Subsection (e) specifically commands that the rights of each class of creditors and stockholders be accorded due consideration."

The First Mortgage Trustees, in the brief heretofore filed on their behalf in this proceeding, contended that substantially all of the Debtor's property, except certain cash and securities therein specified, is subject to the lien of the First Mortgage as a first lien, and they asked that the Commission, in approving a plan for the Debtor pursuant to subsection (d) of Section 77, take this contention as its premise or starting point.

The findings of the Report (pages 48-52) sustain in every respect this contention of the First Mort-

gage Trustees and reach the conclusion (page 52) that

"While due recognition must be accorded to the rights of the creditors with whom are pledged general mortgage bonds, those creditors are not entitled to the same treatment as first mortgage bond holders, who should be considered as having a first lien upon practically all of the assets of the debtor. It follows that holders of the debtor's first mortgage bonds should receive securities of a higher rank than other creditors, at least to the extent that existing conditions will permit."

The First Mortgage Trustees believe, however, that the plan recommended by the Report (hereinafter referred [559] to as the "Plan") departs in several important respects from the principle of First Mortgage priority above stated and that, to the extent that it does so depart, the Plan does not conform to the requirements of Section 77.

## II.

The Plan Discriminates Unfairly Against the Holders of Existing First Mortgage Bonds in Its Treatment of Unpaid Interest on Said Bonds.

(Exceptions 1 and 2.)

The Plan provides that the holders of existing First Mortgage Bonds (hereinafter sometimes referred to as the "First Mortgage Bondholders")

shall receive, in respect of their unpaid interest, new common stock of a par value equal to the amount of such interest. The Plan further provides that the junior secured creditors (Reconstruction Finance Corporation, Railroad Credit Corporation, and A. C. James Company) shall receive new common stock of an aggregate par value equal to the aggregate amount of their claims for principal and unpaid interest, such stock to be distributed among the individual creditors proportionately to the General and Refunding Mortgage Bonds held by them as collateral rather than proportionately to the amount of their claims.

Clearly, these provisions of the Plan discriminate unfairly against the First Mortgage Bondholders and in favor of the junior secured creditors and depart from the principle [560] of First Mortgage priority upon which the Plan is predicated.

The right of the First Mortgage Bondholders to priority in respect of their unpaid interest is not questioned by the Report; on the contrary, the Report states (page 53) that "the rights represented by unpaid interest should be recognized with the principal of the debt." Nevertheless, the Plan accords to them, in respect of their unpaid interest, neither a qualitative nor a quantitative preference. They are offered, on a dollar for dollar basis, securities of the same rank as the securities offered to the junior secured creditors.

The First Mortgage Trustees believe that the First Mortgage Bondholders should receive, in re-

spect of their accrued interest, securities of a higher rank—at least preferred stock—than those offered to the junior secured creditors.

### III.

**The Plan Discriminates Unfairly Against the Holders of Existing First Mortgage Bonds. Its Provision for Non-Cumulative Interest on the New Income Mortgage Bonds.**

(Exception 3.)

The Plan provides that the new income mortgage bonds, to be allotted to the First Mortgage Bondholders in respect of [561] 40% of their claim for principal, shall bear interest at the rate of 4% per annum, payable semi-annually only out of available net income determined on the basis of six months' income periods ending June 30 and December 31 in each year and further provides that such interest shall be "cumulative only as against such available net income for the income period in respect of which such interest is payable" (page 43).

The discriminatory nature of these provisions becomes apparent when it is considered that the earnings of the Debtor are seasonal, being consistently much lower during the first six months of the year than in the last six months. As a result of the non-cumulative feature, "the cards are stacked" against the First Mortgage Bondholders. Except in unusually prosperous years, their chances of receiving more than a 2% annual return on their new income

mortgage bonds are slight, although the earnings on an annual basis may be more than sufficient for the payment of full 4% interest.

Furthermore, as indicated in the Report (page 22), the earnings of the Debtor fluctuate widely from year to year. Even if interest on the new income mortgage bonds were made cumulative against available net income for each annual period, the First Mortgage Bondholders would bear the full brunt of low earnings in a "lean" year without having an opportunity [562] to share in the excess earnings of a succeeding prosperous year.

So drastic a limitation upon the right of the First Mortgage Bondholders to share in the income of the Debtor discriminates unfairly against them and in favor of the junior creditors who are to receive new common stock under the Plan, and in this respect the Plan fails to afford due recognition to the rights of the First Mortgage Bondholders in respect of such income.

The First Mortgage Trustees believe that the Commission should eliminate the discrimination resulting from seasonal earnings by making interest on the new income mortgage bonds cumulative at least against available net income for each annual period. They further believe that the Commission should eliminate the discrimination resulting from fluctuations of earnings from year to year by making such interest cumulative against available net income for a reasonably longer period—not less than three years.

## IV.

The Plan Discriminates Unfairly Against the Holders of Existing First Mortgage Bonds in Its Provisions Relating to the Issue of New First Mortgage Bonds.

\*(Exceptions 4, 5 and 6.)

An outstanding feature of the Plan is a drastic scaling down both of debt structure and of fixed and contingent [563] charges. The issue of new first mortgage bonds for the purposes of the Plan is limited to \$10,000,000 principal amount, all of which are to be sold to provide new money. No new first mortgage bonds are allotted to the First Mortgage Bondholders, who are to receive securities subordinate in every respect to the new first mortgage bonds.

The Plan provides that the \$10,000,000 principal amount of new first mortgage bonds shall be sold at par, with a bonus of 10 shares of new common stock for every \$1,000 principal amount of bonds purchased, and it offers preferential rights to purchase the bonds on these terms to The Western Pacific Railroad Corporation (an unsecured creditor and the sole stockholder of the Debtor), to the junior secured creditors, and to the First Mortgage Bondholders, in the order named.

The First Mortgage Trustees believe that these provisions of the Plan involve an unfair discrimination against the First Mortgage Bondholders in two respects, viz.:

(a) in failing to offer them new first mortgage bonds for at least a portion of their claims, and [564]

(b) in offering to the sole stockholder and to the junior secured creditors preferential rights to purchase new first mortgage bonds on unduly favorable terms.

(a) As Regards the Failure to Offer the First Mortgage Bondholders New First Mortgage Bonds for at Least a Portion of Their Claims.

The First Mortgage Trustees believe that any plan approved by the Commission should preserve the first lien position of the First Mortgage Bondholders to the greatest extent consistent with the requirement that (to use the language of the Report) "the plan must provide a capital structure for the reorganized company which will give it a reasonable opportunity to function efficiently and continuously as a going concern" (page 36). Any plan which unnecessarily sacrifices their first lien position is not "fair and equitable" as regards the First Mortgage Bondholders.

The First Mortgage Trustees believe that the first lien position of the First Mortgage Bondholders can be preserved as to at least a portion of their claims without creating a capital structure inconsistent with the requirement above stated. For example, the issue to the First Mortgage Bondholders

of a reasonable amount of new first [565] mortgage bonds (in lieu of a like amount of new income mortgage bonds allotted to them in the Plan) would not involve any increase in either the total debt structure or the total charges—fixed and contingent—contemplated by the Plan, and the First Mortgage Trustees believe that it would not involve an undue increase in the fixed charges.

The extent to which the first lien position of the First Mortgage Bondholders can be preserved is governed, of course, by the further requirement that adequate provision should be made for obtaining new capital without exceeding the limits of a sound debt structure. The Plan limits the total authorized issue of new first mortgage bonds to \$50,000,000 principal amount. With only \$10,000,000 principal amount immediately required to be issued for new money, the First Mortgage Trustees believe that reasonable provision can be made for issuing new first mortgage bonds to the First Mortgage Bondholders and still leave an ample margin to meet the requirements of future capital financing.

(b) As Regards the Offer to the Sole Stockholder and to the Junior Secured Creditors of Preferential Rights to Purchase New First Mortgage Bonds on Unduly Favorable Terms.

As now contemplated by the Plan, the \$10,000,000 principal amount of new first mortgage bonds to be [566] presently issued for new money will be the sole first lien on property having a value (see pages 22-23 of the Report) well over \$100,000,000;

they will be issued to finance capital expenditures of a corresponding amount under a rehabilitation program calculated to put the property in excellent physical condition and to effect substantial operating economies, and they will carry a 4% fixed interest charge which, according to the findings in the Report, will have an adequate coverage of earnings. Considering these factors, it seems reasonable to believe that these bonds can be sold at not less than par without any stock bonus. Nevertheless, the Plan offers to the purchasers a bonus of new common stock aggregating 100,000 shares (out of a total authorized issue of 300,682-1/5 shares) and giving an aggregate par value of \$10,000,000. Moreover, the Plan offers preferential rights to purchase these bonds at par, with this stock bonus, first to the sole stockholder of the Debtor and next to the junior secured creditors.

If, as the First Mortgage Trustees believe, the \$10,000,000 principal amount of new first mortgage bonds can be sold at par without any stock bonus, these provisions of the Plan discriminate unfairly against the First Mortgage Bondholders and in favor [567] of the sole stockholder and the junior secured creditors. Their effect is to permit the sole stockholder or the junior secured creditors to acquire a first lien position on the property (to the entire exclusion of the First Mortgage Bondholders), and in addition a large share of the equity, by paying no more (and possibly less) than the market value of the new first mortgage bonds. If the bonds

are purchased by The Western Pacific Railroad Corporation, the result will be a donation of new common stock to a stockholder (who is also one of the unsecured creditors) whose equity, according to the findings of the Report (page 55), has no value; if the bonds are purchased by the junior secured creditors, the gratuitous increase in their allotments of new common stock will accentuate the discrimination in their favor which is discussed under Point II. of this brief.

The conclusion in the Report (page 56) that "The provision for the participation of the unsecured creditor would not discriminate against \* \* \* the first mortgage bondholders \* \* \* because such unsecured creditor must contribute \$1,000 in cash for each new \$1,000 bond and 10 shares of new common stock received" can be accurate only if the value of the bonds and stock received does not exceed the amount of cash contributed. [568]

The First Mortgage Trustees believe that the Commission should give effect to the principle of First Mortgage priority as regards the issue of new first mortgage bonds, (a) by providing for the issue of new first mortgage bonds to the First Mortgage Bondholders in respect of at least a portion of their claims, and (b) by eliminating stock bonuses in connection with the sale of the \$10,000,000 principal amount of new first mortgage bonds to be sold to provide new money, except to the extent that such stock bonuses may, in the judgment of the

Commission, be required to insure the salability of the bonds at par.

V.

To the Extent That the Plan Fails to Give Effect to the Principle of First Mortgage Priority, It Fails to Meet the Requirements of Section 77 of the Bankruptcy Act.

(Exceptions 7 and 8.)

The foregoing discussion has indicated certain respects in which the Plan departs from the principle of First Mortgage priority upon which it is predicated. In these respects the First Mortgage Trustees believe the Plan fails to meet the requirements of Section 77 of the Bankruptcy Act, in that

[569]

(a) it is not fair and equitable as regards the First Mortgage Bondholders,

(b) it does not afford due recognition to the rights of the First Mortgage Bondholders,

(c) it discriminates unfairly against the First Mortgage Bondholders and in favor of junior creditors and stockholders, and

(d) it does not conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders.

The First Mortgage Trustees also believe that in these respects the Plan is not compatible with the public interest.

## VI.

## Conclusion.

The First Mortgage Trustees ask that the Commission, in approving a plan for the Debtor pursuant to subsection (d) of Section 77 of the Bankruptcy Act, give full effect to the principle of First Mortgage [570] priority which the Report adopts as its premise or starting point.

Respectfully submitted,

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(Here follows certificate of service.)

[Endorsed]: Filed Oct. 5, 1939. [572]

Before the  
Interstate Commerce Commission

Finance Docket No. 10913

In the Matter

of

THE WESTERN PACIFIC RAILROAD  
COMPANY REORGANIZATION

Brief on Behalf of

Frederick H. Ecker, John W. Stedman and Reeve  
Schley, as a Committee Representing a Group  
of Not Exceeding Twenty-five Bona Fide Hold-  
ers of the First Mortgage Bonds of The West-  
ern Pacific Railroad Company

In Support of

Exceptions (Hereto Annexed) to Proposed Report  
of the Bureau of Finance. [573]

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## I.

## Introductory Statement.

## A. Scope of this brief.

Western Pacific Railroad Company (hereinafter called the Debtor) filed its petition under Section 77 of the Federal Bankruptcy Act on August 5, 1935.

The Debtor on February 8, 1936, filed its plan of reorganization, hereinafter called the Debtor's Plan.

Two additional plans have been submitted, a plan prepared by the Bondholders' Committee (hereinafter called the Bondholders' Plan) and a plan prepared on behalf of A. C. James Co. (hereinafter called the James Plan). [580]

The proposed Report of the Bureau of Finance rejects all three of these plans and recommends a wholly new plan (hereinafter called the Bureau Plan).

It is the firm belief of the Bondholders' Committee that the Bondholders' Plan, as originally filed, but in any event with the modifications hereinafter indicated, both (1) is compatible with the public interest and (2) affords due recognition to the rights of each class of security-holders.

It is the equally firm belief of the Bondholders' Committee that the Bureau Plan neither (1) is compatible with the public interest nor (2) affords due recognition of the rights of each class of security-holders.

This brief will discuss only the issues between the Bondholders' Plan and the Bureau Plan. The Bond-

holders' Committee and its counsel therefore rely upon, and request the Commission carefully to examine, their earlier brief of January 9, 1937, in respect of the issues between the Bondholders' Plan on the one hand and the Debtor's Plan and the James Plan on the other hand, particularly since on many of them the proposed report of the Bureau of Finance is supported by, and entirely in accord with, the arguments advanced in that brief.

### B. Present Capital Structure.

The Debtor was organized in 1916 to acquire in reorganization the properties of its predecessor. In the 1916 reorganization all bonds (aggregating \$75,000,000) and all other debt of the predecessor were wiped out, as debt, and the Debtor's presently outstanding stock was issued in lieu thereof. \$20,000,000 principal amount of the Debtor's First Mortgage Bonds were issued in the 1916 reorganization for new money. Commencing in 1921, additional First Mortgage Bonds have been issued for [581] capital expenditures, all with the approval of the Commission under Section 20a of the Transportation Act. Junior General and Refunding Mortgage Bonds have also been issued, with the approval of the Commission, for capital expenditures, and in turn pledged to secure notes for loans by Reconstruction Finance Corporation, hereinafter called RFC; The Railroad Credit Corporation, hereinafter called RCC; and A. C. James Co., hereinafter called ACJ. In addition, the Debtor has certain unsecured

unfunded obligations to its sole stockholder, Western Pacific Railroad Corporation, hereinafter called the Western Pacific Corporation, and to the latter's subsidiary, Western Realty Company (Ex. 105).

As a result, the capital structure of the Debtor as of January 1, 1937, was:

Equipment obligations .....	\$ 2,408,190
First Mortgage 5% Bonds .....	49,290,100
Accrued Interest .....	8,214,766
RFC Note .....	2,963,000
Accrued Interest .....	426,753
Secured by pledge of \$10,750,000 General and Refunding Bonds.	
RCC Note .....	2,482,148
Accrued interest .....	114,156
Secured by pledge of \$4,000,000 General and Refunding Bonds.	
James Note .....	4,999,800
Accrued interest .....	749,870
Secured by pledge of \$4,249,500 General and Refunding Bonds.	
Unsecured obligations to Western Pacific Corporation (including \$56,667 to its subsidiary, Western Realty Company) including interest .....	7,245,274
Preferred Stock .....	25,300,000
Common Stock .....	47,500,000

[582]

### C. Objective of the Reorganization.

The objective of the reorganization is to create a sound capital structure, which will restore the credit of the property and enable it to perform its public function, and which at the same time, through the character and basis of exchange of the new securities, will provide for the distribution of

income of the reorganized company in accordance with the relative priorities of the various classes of the Debtor's securities.

A prospective debtor's credit lies in the state of mind of his prospective creditors. Railroad credit must therefore depend upon the state of mind of the prospective investors in railroad bonds. The Bondholders' Committee is acting for a substantial number of life insurance companies and other institutions which in the past have been among the principal investors not only in the securities of the Debtor but in the securities of other American railroads.

This case is the first involving a major railroad in reorganization to come before the Commission under Section 77. The action of the Commission in respect of the treatment of First Mortgage Bonds heretofore issued under the Commission's aegis for very recent capital expenditures will have a decisive effect, not merely upon the credit of the Debtor and other railroads in reorganization, but upon the credit of all American railroads.

The Commission should, and it is believed will, approach the problem involved in this proceeding in the spirit expressed by the Commission's own decision in the O'Fallon case as follows (*Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I. C. C. 3, 30):

"The end in view, as we have stated, is the maintenance of an adequate national railway transpor- [583] tation system. Such a system,

so long as it is privately owned, obviously cannot be provided and maintained without a continuous inflow of capital. Obviously, also, such an inflow of capital can only be assured by treatment of capital already invested which will invite and encourage further investment."

D. Summary of the Bondholders' Plan and the Bureau Plan.

That the commission may have in this brief a summary comparison of the Bondholders' Plan and the Bureau Plan, the following table is presented showing the capitalizations, charges and distribution of new securities under the two plans: [584]



1 2 3 2 2 5 2 5  
 7 4 0 7 5 0  
 4 2 6 7 5 3  
 5 2 0 5 3 7  
 1 1 4 1 5 6  
 1 2 4 9 9 5 0  
 7 4 9 8 7 0  
 7 1 8 8 6 0 7  
 1 0 0 0 0 0 0  
 5 6 6 6 7

3 3 4 6 9 8 1 5

	NEW FIRST MORTGAGE BONDS		NEW INCOME MORTGAGE BONDS		NEW PREFERRED STOCK		NEW COMMON STOCK	
	<i>Sunshine</i> Bondholders' Plan 4%	<i>Suggested Compromise</i> Bondholders' Plan 4%	<i>Sunshine</i> Bondholders' Plan 5% Cumulative against 3 years income	<i>Suggested Compromise</i> Bondholders' Plan 4% Non-cumulative on <del>annually</del> rests	<i>Sunshine</i> Bondholders' Plan 6% Non-cumulative on annual basis	<i>Suggested Compromise</i> Bondholders' Plan 5% Non-cumulative on annual basis	<i>Sunshine</i> Bondholders' Plan No Par Value Shares	<i>Suggested Compromise</i> Bondholders' Plan \$100 Par Value Shares
Equipment Trusts <sup>1</sup>								
Old First Mortgage Bonds								
Principal	\$ 9,858,020 (20%)		<i>✓</i> \$19,716,040 (40%)	49,790,100 (100%)	\$19,716,040 (40%)	<del>29,574,000 (60%)</del>	740,750 (17.7%)	12,522,528 (26%)
Interest					8,214,766 (100%)	78,214,766 (100%)		
R. F. C. Note				2,963,600 (100%)			107,500 (317%) <sup>2</sup>	82,147 (100%)
R. C. C. Note				2,482,148 (100%)			40,000 (105%)	95,010 (100%)
A. C. J. Note						4,999,800 (100%)	42,495 (74%)	26,100 (46%)
Western Pacific R. R. Corp.							339,995 (Warrants)	100,000
For New Money	10,000,000	10,000,000					Not less than 150,000 nor more than 300,000	100,000
Total	19,858,020	10,000,000	19,716,040	54,735,248	27,930,806	13,214,566	No. less than 339,995 shares nor more than 489,995 shares	100,000
Fixed Interest Charges	794,320	400,000		2,149,410		660,728		
Contingent Interest Charges			985,802		1,675,848			
Preferred Dividends								

<sup>1</sup> \$2,048,190 undisturbed both plans. Annual charges thereon amount to \$86,473.

<sup>2</sup> No par value shares are taken at \$100 each in computing these percentages.

<sup>3</sup> 150,000 shares were covered by warrants for stock allotted to new money; 189,995 shares are allotted to R.F.C., R.C.C. and A.C.J. and the warrant price is such as to pay off the R.F.C. Note, R.C.C. Note and A.C.J. Note.

<sup>4</sup> Both plans give the opportunity to provide the new money first to Western Pacific Corporation, then to R.F.C., R.C.C. and A.C.J. as a group, and then to the First Mortgage bondholders. The Bondholders' Plan, however, makes no distinction in the proceeds offered to the three classes of debtors; security holders, in order to make the successive offerings, equivalent to an underwriting and insure the raising of the new money, the Bondholders' Plan makes the second and third offerings progressively more favorable to the respective offerors.



## II.

Both the total capitalization and the character of the new securities proposed by the Bondholders' Plan provide a sound capital structure, compatible with the public interest, and permit due recognition of the rights of each class of securityholders, while both the total capitalization and the character of the new securities proposed by the Bureau Plan are so drastically restricted as to impair railroad credit in a manner not compatible with the public interest, and as to prevent due recognition of the rights of the respective classes of securities. (See Exceptions 1 to 25.)

## A. The Statutory Requirements.

Section 77 requires that a railroad reorganization plan shall be "compatible with the public interest." It also requires that it shall be "fair and equitable," that it shall "afford due recognition to the rights of each class of creditors and stockholders," that it shall "not discriminate unfairly in favor of any class of creditors or stockholders," and that it shall "conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders."

As the Bureau's proposed Report points out (p. 36), Section 77 provides no standards by which the public interest shall be determined, with the sole exception that it requires that a plan shall "provide for fixed charges \* \* \* in such amount that, after

due consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there [585] shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof."

The Bondholders' Committee concedes, indeed asserts, that, notwithstanding this lack of specification of standards, the new capitalization must be "sound" and that the Commission should not approve a capitalization which does not bear a reasonable relationship to *all* the relevant factors and "give reasonable opportunity to function efficiently and continuously as a going concern." It asserts, however, that any determination by the Commission which takes regard only of past earnings and those which can be expected in the *immediate* future, and which disregards the other relevant factors is itself not compatible with the public interest.

It is just as important "in the public interest" that a railroad property shall not be grossly undercapitalized in a reorganization proceeding as it is important that it shall not be over-capitalized. It is just as important "in the public interest" that the new securities to be issued by the reorganized company shall not be so restricted in their rights, either as to principal or as to income, as to make it appear that the Commission has no confidence in American railroads, as it is important that the character of the securities shall not be such as to impose a hopeless debt burden or give to equity

securities such impossibility of future return that they will be mere tokens for stock market speculation.

Section 77 was not intended to abrogate as to railroad reorganizations the Biblical injunction to be temperate in all things.

Neither the railroad industry as a whole nor the Western Pacific in particular is obsolete. The railroads generally, and Western Pacific itself, will have need of future capital. The public policy of the United States is [586] that that capital shall be furnished by private investors. But private investors cannot be expected to furnish that capital if the Commission is to impose standards of capitalization in reorganization to which not even the soundest of the American railroads today conform, and which indicate to prospective investors that the cycle from a First Mortgage bond issued with the approval of the Commission, and sold at a price approved by the Commission, to stock under a reorganization plan prepared by the Commission itself is a matter of approximately two decades.

B. The total capitalization contemplated by the Bondholders' Plan is not excessive; that contemplated by the Bureau Plan is unduly low. (See Exceptions 1. to 5.)

The total capitalization proposed by the Bondholders' Plan is less than that proposed either by the Debtor's Plan or by the James Plan. It contemplates securities having a par value of \$69,-

553,056, plus 339,995 shares of Capital Stock without par value.\*

In contrast to this, the Bureau Plan limits the capitalization to \$91,406,510, in securities all of par value.

Were the character of the new securities which the Bureau Plan offers for the present First Mortgage Bonds, and the terms of that offer, such as to recognize the priority of those Bonds as against other creditors, the bondholders would not be directly aggrieved by this drastic reduction in total capitalization, since the amount is large enough to meet all the bondholders' prior claims. However, as will hereinafter be pointed out, the Bureau Plan uses this small permitted capitalization as a justification, first, for refusing [587] to permit the creation of priority securities, even preferred stock, adequate in amount to recognize the bondholders' priorities, and second, for unduly limiting the amount of permissible fixed and contingent interest obligations in the guise of maintaining a conservative debt ratio.

The Bondholders' Committee's further interest in the imposition of this low total capitalization lies

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\*A possible additional maximum of 150,000 shares of Common Stock without par value is provided for issue in connection with the underwriting of the \$10,000,000 of new money, but, as pointed out in the January, 1937, brief on behalf of the Bondholders' Committee, it is not believed that the issue of this additional 150,000 shares will prove to be necessary.

in the fact already pointed out that if the Commission is to have such a pessimistic attitude toward railroad properties, private investors cannot be expected to look with favor upon railroad securities.

As of December 31, 1935, the investment in the properties of the Debtor's system less accrued depreciation aggregated \$146,940,649, and the Commission's valuation for rate making purposes of those properties aggregated \$144,619,851 (Exs. 11, 29, 30, 59). Approximately \$3,700,000 expended in connection with the Debtor's rehabilitation program will represent an addition to both these items (Ex. 38).

This means that the Bondholders' Plan contemplates that the aggregate new securities having par value shall represent but 46% of such investment and but 47% of the Commission's valuation, and that even if the no par value Common Stock be treated as having a capital value of \$100 per share, the total capitalization will aggregate but 69% of such investment and but 70% of the Commission's valuation.

In finding that this seemingly conservative total capitalization proposed by the Bondholders' Plan is not compatible with the public interest, and proposing that total capitalization, all with par value, shall be limited to but 61% of investment less depreciation and but 62% of the Commission's valuation, [588] the proposed Report has imposed standards which, if applied to other American railroads, would demonstrate that even those capital struc-

tures generally regarded as the most sound violate the standards of public interest. Approval of the suggested standards by the Commission will constitute such a shock to railroad credit as to render doubtful the ability of any railroad hereafter to sell any securities on a favorable basis, particularly if issued for more than 50% of future additions and betterments.

C. The aggregate of First Mortgage Bonds and fixed charges contemplated by the Bondholders' Plan are well within all statutory requirements; those proposed by the Bureau Plan are unduly low. (See Exceptions 6 to 12.)

The institutional investors represented by the Bondholders' Committee regard it as important that the Commission adopt standards of reorganization which will permit them to retain their investments in the railroad field as well as to invest some of their funds in that field in the future. They are therefore interested in having as large a part of their present investment remain a First Mortgage fixed charge as sound principles will permit, and they are alarmed at the pessimism with respect to the future of American railroads indicated by the relationship of fixed charges to past and present earnings which the Bureau Plan requires to constitute the "adequate coverage" required by Section 77.

1. The Debtor's "earnings experience."

The consolidated net income of the Debtor's system available for interest on funded debt for the

years 1926-1930 was reported as follows (Ex. 29, S. 9): [589]

1926	\$4,759,282
1927	2,647,494
1928	2,964,371
1929	2,529,846
1930	1,552,487

Such income for the depression years and for 1936 as reported, as adjusted by the Bureau, and as adjusted as required by "relevant facts" hereinafter discussed, was as follows (Ex. 29, S. 8, 9; Ex. 39; Report pp. 21, 39):

	As Reported		As Adjusted by Bureau		Adjusted in Light of "Relevant Facts"
1931	186,708	Deficit	850,000	Deficit	460,350
1932	252,706		400,000	Deficit	489,075
1933	674,097		None		1,175,628
1934	1,084,244		500,000		1,418,527
1935	805,589		250,000		1,495,803
1936	181,102		1,766,632		1,902,033
Average					
1931-1935	525,967		100,000	Deficit	1,007,876

The difference between the 1936 earnings as stated by the Bureau, and those here asserted, represents solely the failure of the Bureau to add back \$135,401 representing amortization of bond discount charged against reported earnings. This apparently was an oversight as the proposed Report recognizes the propriety of such an adjustment (pp. 20, 39).

While the proposed Report does not state exactly how its adjusted earnings for the years 1931-1935, inclusive, were arrived at, its discussion indicates that they were computed as follows: [590]

	1931	1932	1933	1934	1935
Reported Earnings (Ex. 29, S. 9).....	\$186,708 Def	\$252,706	\$674,007	\$1,084,244	\$805,589
Add:					
Amortization Bond Discount (Report, P. 20, 39).....	140,000	140,000	140,000	140,000	140,000
	46,708 Def	392,706	814,007	1,224,244	945,589
Deduct:					
Social Security & Retirement Taxes (Report, P. 20).....	488,633	365,498	331,149	257,345	275,900
Deficiency in Normal Maintenance.....	314,659	427,208	482,858	466,899	420,589
	804,392	792,706	814,007	724,244	695,589
Adjusted earnings (Rep., P. 39).....	850,000 Def	400,000 Def	None	500,000	250,000

Adjusted earnings (Rep., P. 39)..... 850,000 Def    400,000 Def    None    500,000    250,000

For reasons hereinafter explained, it is submitted that the Bureau's adjustment is erroneous and that a true picture of the "earnings experience" of the Debtor can be arrived at only by the following adjustments:

	1931	1932	1933	1934	1935
Reported Earnings (Ex. 29, S. 9).....	\$186,708 Def	\$252,706	\$ 674,007	\$1,084,244	\$ 805,589
Add:					
Amortization of Bond Discount (Ex. 29, S. 23, 28).....	124,323	130,599	134,462	134,500	135,517
Rehabilitation Expenditures (Ex. 29, S. 8, 9).....	122,735				436,036
RR Retirement Taxes (Exs. 58, 59).....				97,683	51,593
Northern California Extension (Ex. 39).....	400,000	400,000	400,000	400,000	400,000
<b>Total</b> .....	<b>460,350</b>	<b>783,306</b>	<b>1,208,469</b>	<b>1,716,427</b>	<b>1,282,735</b>
Deduct:					
Credit RR Retirement Taxes.....					149,267
Deficiency in Normal Maintenance (Based on 33% maintenance ratio).....		294,231	32,841	297,900	183,665
<b>Adjusted Earnings</b> .....	<b>460,350</b>	<b>489,075</b>	<b>1,175,628</b>	<b>1,418,527</b>	<b>1,495,803</b>

*Institutional Bondholders et al.*

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Considering first the necessary additions to reported income:

The Bureau computation adds back to reported earnings for amortization of bond discounts a flat \$140,000 for each of the years concerned (Report, pp. 20, 39). While this is the approximate amount, the immediately foregoing table sets forth the exact amount. [591]

The Bureau computation fails to add anything back during these years for rehabilitation expenditures, although it concedes the propriety of such an adjustment (R. p. 21), and makes an adjustment on that score of the 1936 reported earnings. With reference to this item for 1935, the proposed Report states (p. 21) that "no substantial amount of expenditures was made on account of the rehabilitation program in 1935."

The fact (Ex. 29, S. 8) is that the rehabilitation expenditures in 1935 (equipment and 100 miles of heavy rail) were \$436,036. The record likewise indicates that in 1931 the amount of expenditures made in an effort to overcome existing deferred maintenance amounted to \$122,735 (Ex. 29, S. 9; Ex. 34; Report, p. 19). The foregoing amounts, therefore, on the principles established by the proposed Report, should have been added back, and are so added in the immediately foregoing table.

While the Bureau computation dealt, on the side of deductions, with the item of Social Security and Railroad Retirement taxes, and the exact method of its computation is difficult to determine from the

Report, proper accounting would seem to require adding back to reported earnings for 1934 and 1935 the amounts charged for those taxes in those years, and deducting from 1935 reported earnings the amount credited on the books of the Debtor in that year. Accordingly, this adjustment has been made in the foregoing computation.

The Bureau's analysis of "earnings experience" also overlooks the fact that during a part of the period analyzed, the Northern California Extension, a substantial revenue producer, was not even in operation. That line commenced operation November 10, 1931, and it was not until some time thereafter that the Debtor began to [592] realize substantial additions to its revenues arising from that Extension. Indeed, the Report recognizes (p. 20) that the earning power of the Extension is not reasonably reflected in the earnings reported for 1932 and 1933, but its computation makes no allowance for that fact.

Since, therefore, the reported past earnings of the Debtor represent the "earnings experience" of only a part of the property to be embraced in the system of the Debtor as reorganized, a fair picture of such "earnings experience" must include an adjustment by adding to reported earnings an amount reasonably to be expected from the Northern California Extension after that line has been in use sufficiently long to have become a fully seasoned and developed route.

In referring to the earning capacity of the Northern California Extension, Mr. Elsey, President of the Debtor, said in part (Ex. 39):

"In order to make a true and accurate estimate of the earning power of the Western Pacific Railroad Company, restated retroactively for the period 1930 to 1934, inclusive, it would be necessary in the judgment of the undersigned to increase in each of said years the income available for the payment of fixed charges by an amount not less than \$500,000, which would represent the difference between the net income actually received from the Northern California Extension during the years referred to and the net income which can reasonably be expected from this line during a similar period after the line has been in use long enough to have become a fully seasoned and developed route."

It is clear from Mr. Elsey's statement that the same would hold true for the year 1935, his comments having been confined to the years 1930 to 1934 because his Exhibit 39 [593] deals with certain phases of the Report of the Commission's Bureau of Accounts which was filed as a part of the record on August 6, 1936. That Report covers the years 1930-1934. It will be noted that in Mr. Elsey's judgment earnings available for fixed charges should be increased by not less than \$500,000 per year. However, in order to be conservative, that amount has been reduced 20%, or to \$400,000, in the computation above suggested.

Considering next the necessary deductions from reported income:

In making its computation, the Bureau adjusted the past earnings downward to take into account the expense of recently enacted legislation such as the Social Security tax and the tax under the Railroad Retirement Act. Assuming that any such deduction would be justifiable, the Bureau's adjustment seems to have used the rates provided for in the 1935 Act (p. 20). Those rates are substantially higher than those for the next ten years as required by the 1937 Act. It appears, too, that in computing the Social Security tax the maximum rate has been used for each of the years instead of the sliding scale of rates provided for in the Act. Accordingly, even were some such deduction proper, the deductions made by the Bureau are approximately some \$75,000 to \$150,000 per annum too large.

But it is submitted that no such deduction should have been made.

These items, of course, must be taken into account with respect to *future* earnings, but it presents a wholly erroneous picture of "earnings experience" to attempt to apply them to past earnings for years in which they were not in effect without taking into account any credits which may be expected in the future to offset them for the years in which they will be in effect. To make such a deduction, without making the offsetting credits, as does the Bureau, [594] necessarily assumes that increased costs,

therefore make improper the deduction of those taxes from past earnings to determine "earnings experience." Among these factors are: the continued increase in earnings which has resulted from the opening of the Dotsero Cutoff, the probability of increased business resulting from the proposed entry of the Burlington into the reorganization of the Denver & Rio Grande, the Debtor's principal connection on the East, and the reduction in transportation costs and maintenance expenditures due to the rehabilitation program.

The Bureau's adjustment also made deduction from reported earnings to reflect the admitted deficiencies in the normal maintenance in the depression years (Rep., pp. 38, 39). That this factor requires an adjustment is conceded, but it is believed that the manner of its computation by the Bureau was erroneous. [596]

The Report is silent as to the amounts of such adjustment and the manner in which such amounts were determined. However, by working from the known to the unknown, it is readily determined that the Bureau deducted for maintenance, in 1931, \$314,659, in 1932, \$427,208, in 1933, \$482,858, and in 1934, \$466,899. Since the Report is silent upon the amount of the adjustment for Social Security and Railroad Retirement taxes in 1935, we have been unable to determine accurately the amount of the deduction made by the Bureau either for such taxes or for deficiency in maintenance. The sum of the two deductions is ascertainable, the amount thereof being

\$695,589. Assuming \$275,000 to be the deduction for the Social Security and Railroad Retirement taxes (a wholly reasonable assumption) the amount of deduction in respect of maintenance would be \$420,589.

A simple mathematical calculation reveals that the ratio of the Bureau's normal maintenance to operating revenues in each of the depression years closely approximated 36%. In only one year prior to 1936 has the System's maintenance ratio equalled or exceeded 36%. In 1929 such ratio was 36.677%. In that year the Debtor and its subsidiaries, Sacramento Northern and Tidewater Southern, were in the midst of a vast rehabilitation program. Maintenance expenditures in 1929 aggregated \$6,828,740, of which \$1,305,681 were in connection with the program (Ex. 29, S. 9). This rehabilitation program was started in 1927 and continued through 1930 with a slight carry-over in 1931 (Ex. 29, S. 9). The average maintenance ratio of the System during the 1927 to 1930 period was 35.6%. It seems quite clear, therefore, that the Bureau's figures for normal maintenance, which represent a maintenance ratio of 36%, are decidedly too high and that the deductions made by the Bureau for the def- [597]iciency in normal maintenance were excessive. This is particularly true when due consideration is given to the effect of System expenditures of \$10,105,138 made for rehabilitation in the years 1927 to 1931, inclusive, of which \$6,087,193 were charged to capital accounts (Ex. 29, S. 21, 24, 27).

resulting from such legislation, could not in the past have been offset, and cannot in the future be offset, by increased revenues, resulting from increased rates or otherwise. In so assuming, it plainly erred.

It can hardly be doubted that neither Congress nor the Commission would have imposed these burdens on the railroads during the depression years or that both Congress and the Commission contemplate that the cost of these additional burdens shall in some manner be compensated by increased revenues. It therefore produces a wholly unfair picture of the "earnings experience" to deduct from reported earnings the theoretical costs of these items without taking into account on the side of gross revenues the probable compensating factors.

That increased costs resulting from Federal and State legislation and from wage increases may have to be compensated by an increase in rates has been publicly recognized by at least one member of the Commission. Speaking on September 1, 1937, at Salt Lake City at the 49th annual meeting of the National Association of Railroad and Utilities Commissioners, Commissioner Lee, as quoted by the press, said:

"We must make the best of the situation in which we find ourselves. We are tied up with the railroads and they must earn enough to pay their expenses and something additional.

"We in the West, are very much interested in our freight rates, and it is necessary that

they be made as low as reasonably possible. However, the fact must not be overlooked that a great part of the expenses of the railroads is a matter over which they have but little, if any, control.

"Congress imposes expenses upon them and so do the states. It is not my function or purpose to [595] offer any criticism of our national or state authorities in the enactment of legislation which results in increasing the expenses of the railroads. It is to be expected that there would be disagreement as to the advisability of such measures. I do not propose to go into that. But I am interested in the level of railroad rates which our producers have to bear, and I am interested in carrying out the mandate of Congress that this country be afforded adequate and efficient railroad transportation service.

"The point I want to make is that the railroads will include in the rates which they impose every dollar they are required to spend. If increases in their operating expenses are made necessary, we must expect that such increased expenses will be reflected in the rates we will have to pay."

Quite apart from any possible increase in rates, there are other factors which in the future will tend to offset the application of the Social Security tax and the Railroad Retirement Act tax and which

The record shows that, after the completion of the rehabilitation program in 1938, and on the basis of estimated earnings for 1939 and 1940, a normal maintenance ratio will approximate 30% (Ex. 29, S. 2). Witness Engelbright testified that a maintenance ratio of 33% would more than take care of normal maintenance (R. 236).

A conservative adjustment for the item of subnormal maintenance would, therefore, seem to be effected by a computation on the basis of a normal 33% ratio. This basis has been used in the adjustment above suggested, resulting in deductions of \$294,231 in 1932, \$32,841 in 1933, \$297,900 in 1934, and \$183,665 in 1935. No deductions were required in 1931, expenditures in that year for maintenance, exclusive of rehabilitation, having amounted to \$5,052,625, and the maintenance ratio in respect thereof having been 34.02%.

Accordingly, in determining whether there is "adequate coverage" for the proposed fixed charges of the Debtor as reorganized, the "earnings experience" of the Debtor should be taken as indicated by the figure set forth in the last column on page 11, rather than by the figures taken by the proposed Report.

Both the Bondholders' Plan and the Bureau Plan contemplate that \$2,048,190 of equipment obligations outstanding as of January 1, 1937, and involving fixed charges of \$86,473, shall remain undisturbed. [598]

The Bondholders' Plan contemplates that in addition there shall be issued in the reorganization \$10,000,000 of First Mortgage 4% Bonds to provide the necessary new money and \$9,858,020 First Mortgage 4% Bonds to provide 20% of the principal amount of the present First Mortgage debt. The Bondholders' Plan therefore contemplates total fixed charges of \$880,793.

It will be noted that these fixed charges were more than three times covered by the average earnings of the years 1926 to 1930, inclusive, that they were materially more than covered by the average earnings as properly adjusted for the years 1931 to 1935, inclusive, and, that after making such adjustments, they were covered with a margin of 61% in 1934, of 70% in 1935, and of more than 115% in 1936.

Certainly these fixed charges contemplated by the Bondholders' Plan have the "adequate coverage" based on "earnings experience" which Section 77 requires.

The Bureau Plan, on the other hand, permits, in addition to the equipment obligations, the issue in the reorganization, of but \$10,000,000 First Mortgage 4% Bonds to provide new money, thus permitting fixed charges limited to the low amount of \$486,473.

This means that the Bureau Plan requires for compliance with the test of "adequate coverage" based on "earnings experience," average earnings for the years 1926 to 1930, inclusive, of 5.94 times

the proposed fixed charges, average earnings, as adjusted, for the years 1931 to 1935, inclusive, of 2.07 times, average earnings, as adjusted, for the years 1934 to 1936, inclusive, of 3.30 times, and earnings for the year 1936 of 3.91 times.

Certainly the imposition of any such limitation upon permissible fixed charges goes far beyond the requirements of "adequate coverage" based on "earnings experience." [599]

Again, the application of any such standard generally would indicate that a substantial number of railroads generally regarded as conservatively capitalized, and as having a conservative ratio of debt to stock, are in need of reorganization.

For example, the fixed charges of the Pennsylvania were covered by average earnings for the years 1934 to 1936, inclusive, only 1.34 times, those of the Santa Fe only 1.68 times, and those of the Burlington only 1.40 times.

Again, the fixed charges of the Pennsylvania were covered by earnings for the year 1936 only 1.49 times, those of the Santa Fe only 1.77 times, those of the Burlington only 1.54 times and those of the Union Pacific only 2.51 times.

Thus the example of these eminently sound roads supports the "adequacy" and conservatism of the "coverage," based on "earnings experience," of the fixed charges proposed by the Bondholders' Plan and demonstrates the extreme reduction of fixed charges contemplated by the Bureau Plan.

Not only is there no necessity, from the standpoint of earnings experience, that the First Mortgage obligations and fixed charges should have the large coverage which the Bureau Plan requires, but in the light of the experience of the last two years, it may well be doubted whether the Bondholders' Plan itself did not reduce the proposed fixed charges materially below those required by the rule of "adequate coverage".

2. "Probable prospective earnings".

When the problem of the permissible amount of fixed charge obligations is approached from the standpoint of "probable prospective earnings", whether for the immediate [600] future or for the long term future, the unfairness of the proposals of the Bureau Plan becomes increasingly apparent, and the blow of those proposals to railroad credit increasingly aggravated.

The consolidated income available for interest as estimated in the forecast last filed by the Debtor in this proceeding was as follows (Ex. 38):

1936	\$1,521,386
1937	2,180,586
1938	2,738,886
1939	3,365,836
1940	3,769,836

These figures are lower than those used in the proposed Report (p. 21) which are those from Statement 2 of Exhibit 29, an Exhibit revised by Exhibit 38, from which the above figures were taken.

The proposed Report gives little credence to these estimates, characterizing them as resting "upon uncertainties" (p. 16) and as "unduly optimistic" (p. 22). Of course, all estimates for the future must involve some uncertainties. It was because the Bondholders' Committee believed that the estimates of the officers of the Debtor might be "unduly optimistic" that the Bondholders' Plan contemplated the very low amount of fixed charges which it does.

However, whereas in June, 1936, the officers of the Debtor estimated that the 1936 system earnings available for interest would aggregate \$1,521,386 and that those for 1937 would aggregate \$2,180,586, the earnings actually realized in 1936 (after the adjustments conceded by the proposed Report to be proper, pp. 20, 21, 39) aggregated \$1,902,033, or 25% in excess of the Debtor's estimate, while those for 1937, based on actual experience to September 1, 1937, are now expected to aggregate \$2,600,000, or 20% in excess of the Debtor's estimate.

It would therefore seem that not only the proposed Report, but even the Bondholders' Committee, were unduly pessimistic and that the proposed Report is unjustified in characterizing the estimates as "unduly optimistic".

The fixed charges contemplated by the Bondholders' Plan clearly have "adequate coverage \* \* \* after due consideration of the probable prospective earnings". They are covered by the now probable

1937 earnings with a margin of 194% and by the average estimated earnings for the years 1937 to 1940, inclusive, by a margin of 254%.

The Bureau Plan, however, requires that fixed charges shall be limited to an amount which will be covered by the now probable 1937 earnings with a margin of 434% and by the estimated earnings for the years 1937 to 1940, inclusive, with a margin of 541%. Again the standard of "adequate coverage \* \* \* after due consideration of the probable prospective earnings," imposed by the Bureau Plan goes far beyond that prescribed by Section 77 and is such as to shock the confidence of the investor in the future of railroad securities.

But again, the proposed Report seeks to justify its pessimistic attitude toward future earnings coverage by suggesting adjustments for various items of expense such as taxes under the recent Federal legislation and probable wage increases, without giving any recognition to probable offsetting factors such as the hope of recapture of substantial amounts of traffic from motor trucks, increased rates which the Commission must necessarily authorize to meet rising costs and the possibility that the growth of California territory served by the Debtor's system, including recently constructed branches, and the revenue producing possibilities of the Dotsero Cut-[602] off and the Northern California Extension may have been under-estimated rather than over-estimated. The actual experience of the last two years (1936 and 1937) would seem to indicate this latter factor to be a probability.

3. No reduction of the fixed charges contemplated by the Bondholders' Plan is necessary to effect the sale in the reorganization of \$10,000,000 First Mortgage 4% Bonds at par.

The Bureau Plan, as already indicated, limits the new First Mortgage Bonds to those to be sold to provide the \$10,000,000 of necessary new money, and then accentuates its hopelessness as to the investment character of railroad bonds by adding (p. 52), "To facilitate the sale of the bonds at par, it is recommended that the plan provide that 10 shares of the new Common Stock be given to the purchaser of each \$1,000 principal amount of the new bonds." This Common Stock bonus constitutes approximately one-third of the entire equity in the Debtor's property as reorganized, subject only to prior securities aggregating \$61,338,290 in principal amount and to \$2,753,818 in total prior charges, most of the latter having also (unnecessarily, as will hereinafter be pointed out) been made non-cumulative.

There is not the slightest evidence in the record to support either the inference that the First Mortgage Bonds contemplated by the Bondholders' Plan would not be saleable at par or that any such bonus would be necessary to support the sale at par of such a First Mortgage bond as that contemplated by the Bureau Plan.

The fixed charges under the Bondholders' Plan constitute but 46% of the actually realized available income [603] for 1936 and but 34% of that now

estimated for 1937. Its First Mortgage Bonds will constitute a first lien at the rate of but \$8,665 per mile of the Debtor's system and of but \$12,450 per mile of main line first track.

The Bureau Plan limits the First Mortgage Bonds to but \$4,365 per system mile and \$6,270 per mile of main line first track, with fixed charges of but 25% of available income for 1936 and 18% of that now estimated for 1937.

That, but for the injury to railroad credit which would result from the imposition of the standards contemplated by the Bureau Plan, bonds of the character proposed by the Bureau Plan would not only not require the exaggerated Common Stock bonus proposed by the Bureau Plan to enable them to bring par, but would actually command a premium without any such bonus, is evidenced by the record of recent sales on the New York Stock Exchange of comparable bonds.

The following bonds, which are outstanding in amounts in excess of \$10,000,000, and which, although because they have been outstanding for substantial periods of time and have become qualified as legal investments for savings banks, are otherwise comparable for the present purpose, are but a few instances of bonds recently selling on an interest yield basis of 4% or less. They had as to 1936 income the following earnings coverage and are outstanding at the following rates per mile of road covered by their lien. [604]

	① Last sale week ending Sept. 23	② Outstanding and pledged including prior liens per mile of road	③ Times interest earned on issue in 1936	④ Times fixed charges earned in 1936
<b>4% Bonds</b>				
Atchison, Topeka & Santa Fe Railway Company				
Transcontinental Short Line, First, 1958	\$112½	20,268	2.49	1.77
General, 1955	110	21,848	2.49	
Atlantic Coast Line Railroad Company				
First Consolidated, 1952	100½	15,915	3.27	1.29
Baltimore & Ohio Railroad Company				
First, 1949	98	94,110	3.18	1.14
Chicago, Burlington & Quincy R. R. Company				
Illinois Division, First, 1949	109¾	52,059	4.6	1.54
General, 1958	110	21,909	2.49	
Northern Pacific Railway Company				
Prior Lien and Land Grant, 1997	102½	19,486	3.69	1.13
Southern Pacific Railroad Company				
First Ref., 1955	103¾	55,425	1.49	1.23
Central Pacific First Ref., 1949	107¾	73,905	1.95	
Union Pacific Railroad Company				
First Lien and Refunding, 2008	165¾	55,197	2.95	2.51
<b>3¾% Bonds</b>				
Pennsylvania Railroad Company				
General, Ser. "C", 1970	98½	164,291	3.22	1.49
<b>3½% Bonds</b>				
New York Central Railroad Company				
Lake Shore & Mich. So. Ry., First, 1997	101½	50,384	4.81	1.16

①Source: Poor's Railroad Service.

②Source: Moody's Railroad Service.

The Bondholders' Committee believes that the foregoing facts establish the conservatism of the provisions of the Bondholders' Plan with respect to First Mortgage Bonds and fixed charges and that the Commission should approve those provisions of the Bondholders' Plan without modification.

It should also be pointed out in this connection that the Bondholders' Plan itself provides for the adjustment of the coupon rate upon the \$10,000,000 of First Mortgage Bonds to be sold to provide the new money, in the light of money conditions at the time of the sale and that it also provides, as will be more specifically discussed later in this brief (*infra*, pp. 44-45), insurance of the raising of the new money by a sliding scale of offers to the Debtor's [605] securityholders in inverse order of their priority, and by provisions for underwriting.

D. The total interest charges, both fixed and contingent, contemplated by the Bondholders' Plan are conservative and compatible with the public interest, in the light of both "earnings experience" and "probable prospective earnings". (See Expositions 13 to 14.)

The Bondholders' Plan contemplates Income Mortgage 5% Bonds, with contingent interest of \$985,802, which, when added to the fixed charges, results in total fixed and contingent interest charges of \$1,866,595.

The Bureau Plan contemplates Income Mortgage 4% Bonds, with contingent interest of \$788,642 and

a total interest charge, fixed and contingent, of only \$1,275,115.

The total charges contemplated by the Bondholders' Plan were thus actually realized in 1936 and will, it is now estimated, be exceeded in 1937 by 39%. The coverage provided by the estimated earnings for the years 1938, 1939 and 1940 will range from a margin of 47% to a margin of 102%, so that within a very few years the indicated coverage by "probable prospective earnings" will be a ratio in excess of the 50% margin required by the laws of the State of New York to qualify bonds as savings bank investments.

The Bureau Plan permits contingent interest charges only to an amount which, with fixed interest charges, was more than covered in both 1934 and 1935, was covered with the savings bank margin of more than 50% in 1936; and it is estimated will be earned twice over in 1937.

The general imposition in reorganization proceedings of such standards would in many cases not only require complete elimination of capital stocks and substantial elimination of junior bonds recently issued with Com- [606] mission approval, but would require the substantially complete conversion into stock of many senior liens heretofore regarded as prime investments. Such a drastic conversion of debt into stock would constitute an added blow to railroad credit generally, which it is submitted is not "compatible with the public interest."

E. The Income Mortgage Bonds proposed by the Bureau Plan are not of a character either compatible with the public interest or permitting due recognition of the priority of the present First Mortgage Bondholders. (See Exceptions 15 to 18.)

1. Interest rate.

Although the present First Mortgage Bonds bear interest at 5% per annum and the Bondholders' Plan contemplates that the Income Mortgage Bonds shall bear 5% interest, the Bureau Plan reduces the rate to but nominally 4%. If the bondholders are to be required to surrender their fixed charge return which is prior to that of all other classes of securityholders, they should not be required to make the additional sacrifice of accepting a 25% reduction in the nominal rate of their contingent return when, as already demonstrated, neither "earnings experience" nor "probable prospective earnings" indicate any necessity for such a reduction.

The Commission should therefore approve the coupon rate of 5% upon the Income Mortgage Bonds to be issued in the reorganization.

2. Their non-cumulative character.

One provision with respect to the Income Bonds made in the Bureau Plan works such an injustice upon the In- [607] come bondholders that it must have been an oversight on the part of the Bureau. The Bureau Plan (pp. 41, 43) provides that the interest on the Income Bonds shall be determined and be payable for each six months income period ending June 30 and December 31 and that such

interest shall be "cumulative only against such available net income for the income period in respect of which such interest is payable." That this makes the Income Bonds wholly noncumulative on the basis of six months rests is indicated by the title of "Non-cumulative Income Mortgage 4% Bonds" given on page 46 of the Report. This provision would make the nominal 4% rate actually but a 2% rate, for the income of the Debtor is seasonal, being realized almost wholly in the last six months of the year (R. 290). The income for the periods ending June 30 and December 31 for each year since 1927, adjusted only to eliminate amortization of bond discount in each year and to eliminate expenditures of rehabilitation program in 1936 and 1937 was as follows:

	Jan.-June	July-Dec.	Calendar Year
1927	562,140	2,221,117	2,783,257
1928	19,155	3,052,136	3,071,291
1929	627,732	2,015,374	2,643,106
1930	918,305 def.	2,588,372	1,670,067
1931	904,451 def.	841,168	63,283 def.
1932	813,830 def.	1,196,438	382,608
1933	437,703 def.	1,245,476	807,773
1934	234,756	983,254	1,218,010
1935	192,483 def.	1,133,474	940,991
1936	225,664 def.	2,127,697	1,902,033
1937	213,381		

It is obvious, therefore, particularly when account is taken of the fact that, under both the Bondholders' Plan and the Bureau Plan, income can be taken for the Capital [608] Fund before it is applied to the payment of interest on the Income Bonds, that the holders of Income Bonds could,

even in the best years, receive for the first six months interest period little, if any, return. Accordingly the bonds would really be 2% bonds. This means, of course, that they could never attain a market value in excess of 50% of their par value, if that, and that the Bureau Plan, through this provision, in effect permanently confiscates, for the benefit of junior securities of the Debtor, one-half of the 40% of principal allotted in Income Bonds, or 20% of the total principal of the First Mortgage Bondholders' present claim.

But "due recognition" of the present bondholders' rights requires a further right of accumulation of interest on the new Income Bonds.

The proposed Report states (p. 22) that the Debtor's volume of traffic, and therefore, of course, its earnings, "is subject to wide fluctuations." It was to take care of these fluctuations that the Bondholders' Plan provided that the interest on the Income Mortgage Bonds shall be cumulative for the limited period of three years.

As more fully pointed out in the January, 1937, brief of the Bondholders' Committee, the Bondholders' Committee recognized the dangers which lie in making contingent interest fully cumulative and therefore recognized, in the preparation of the Bondholders' Plan, that the amount of contingent interest contemplated by that Plan was such as to make it unwise that that interest be fully cumulative. But unless income bond interest, however it may be limited in annual amount, is made cumula-

tive for the limited period of three years as provided in the Bondholders' Plan, the loss due to the fluctuation in earnings which the proposed Report points out, falls upon the [609] present First Mortgage Bondholders. Interest lost in one year as a result of the non-cumulative provision would be gone forever. Though low earnings might be more than offset in subsequent periods of high earnings, the benefit of those high earnings could not recoup the losses of the Income Mortgage Bondholders but would enure progressively downward to the lower classes of the Debtor's securities, ultimately redounding to the sole benefit of the Common Stock. This is unfair to the Income Bonds and, particularly when coupled with the suggested 4% nominal coupon rate, would prevent the Income Bonds ever selling at par. As hereinafter pointed out (*infra*, pp. 39-41, 50-53), this violates the "law of the land" as to "due recognition" of the rights of the present bondholders as enunciated by many decisions of the United States Supreme Court and expressly recognized in the proposed Report.

The Bondholders' Committee therefore urges that the Commission adopt the provision of the Bondholders' Plan that interest on the Income Bonds shall be cumulative for some limited period and that any period less than three years would be unfair to the Income bondholders.

### 3. Authorized amount.

The proposed Report seems to indicate (p. 40 and p. 42) the belief of the Bureau that the Income

Mortgage Bonds should be available for future financing.

While the Bondholders' Plan did not so provide, the Bondholders' Committee would have no objection to modifying the Bondholders' Plan by opening the Income Mortgage for future financing under conservative restrictions; indeed, the Bondholders' Committee thinks this a wise suggestion. [610]

F. The rights of the Preferred Stock contemplated by the Bondholders' Plan provide fairer treatment of the present bondholders than the rights of the Preferred Stock contemplated by the Bureau Plan, and are compatible with the public interest. (See Exceptions 19 to 22.)

The rights of the new Preferred Stock are defined in substantially the same manner in the Bondholders' Plan and in the Bureau Plan except that (1) the dividend rate provided in the Bondholders' Plan is 6% while that provided in the Bureau Plan is 5%, (2) the Sinking Fund is taken out of available net income after Preferred dividends under the Bondholders' Plan while it is taken out of available net income before Preferred dividends under the Bureau Plan, and (3) under the Bondholders' Plan Preferred Stock is given the right, until its earning power has been established, to elect a majority of the Board of Directors, whereas under the Bureau Plan the voting power of each share of Preferred Stock is wholly *pari passu* with that of each share of Common Stock.

The Bondholders' Committee believes that the bondholders are entitled to a 6% dividend on the Preferred Stock in any year in which the earnings suffice to pay that dividend. The Bureau's own analysis of the situation indicates the Bureau's belief that there will often be years in which dividends on this stock will not be earned. Since the dividend is non-cumulative except to the extent that it is earned, dividends not earned in any year are lost forever. To compensate for the failure to pay dividends in years of low earnings, the Bondholders' Committee argues that the Commission should permit the payment of a 6% dividend in years of high earnings. [611]

While it is true that the Preferred dividends under the Bondholders' Plan will exhaust the consolidated available net income estimated for the immediate future, there is no reason of public policy preventing the payment of substantially all the income possible in the immediate future to the present First Mortgage Bondholders in those years in which such income is realized. The bondholders today have a claim ahead of all other securityholders for fixed interest every year at the rate of 5% upon their bonds. For several years they cannot hope to receive anything like that return. To provide that in years of prosperity the deficits of the lean years shall be partly compensated by the payment of the additional rate of 1% on that part of their present investment which is to be commuted into Preferred

Stock seems not only not violative of the public interest, but demanded by all reasons of equity.

The Bondholders' Committee also believes that it is unfair to the bondholders to pay off the Income Bonds issued to them by depriving them of any current return on that part of their present investment which is commuted into Preferred Stock. Accordingly, it believes that the placing of the Sinking Fund ahead of the Preferred Stock dividend as provided in the Bureau Plan rather than behind it as provided in the Bondholders' Plan does not "accord due recognition" to the rights of, the bondholders.

The Bondholders' Committee also believes that in view of the fact that the Preferred Stock represents the prior and major interest in the property, the right to elect a majority of the Board of Directors should be vested in the Preferred Stock until its earning power has been established. In view of the facts that the Common Stock and Preferred Stock are so nearly equal in number of shares and that the Preferred Stock will be held by widely scattered holders while large blocks of the Common Stock, constituting a large majority thereof, will be held by RFC, RCC, ACJ and Western Pacific Corporation, the Bureau Plan will result in practical control of the Board being vested in those having the most remote and least valuable interest in the property. For reasons which were fully argued in its January, 1937 brief (pp. 27-31), the Bondholders' Committee believes that

the public interest, as well as due recognition of the prior rights of the respective securityholders, requires the adoption of the provision of the Bondholders' Plan with respect to the Preferred Stock voting power.

However, if after its fair consideration of the problem, the Commission shall disagree with the Bondholders' Committee and shall support the position of the Bureau Plan in respect of these three differences in the rights of the Preferred Stock, the Bondholders' Committee does not believe that modification of the Bondholders' Plan upon these points alone would make it unacceptable.

G. The amount of Preferred Stock contemplated by the Bureau Plan is insufficient to permit due recognition of the prior rights of the present bondholders. (See Exceptions 19 and 23.)

The amount of Preferred Stock to be issued under the Bondholders' Plan is \$27,930,800, while the amount contemplated by the Bureau Plan is \$29,574,060. This difference is due to the fact that the Bondholders' Plan allots Preferred Stock for 40% of the principal of the present bondholders' claims and for all the interest to the effective date of the Plan, while the Bureau Plan allots Preferred Stock for 60% of the principal of the claims and Common Stock for the interest. [613]

For the reasons argued in full in the January, 1937, brief of the Bondholders' Committee (pp. 67-80) and set forth in the proposed Report itself (p. 52), the law of the land requires "that holders

of the Debtor's First Mortgage Bonds should receive securities of a higher rank than the other creditors, at least to the extent that existing conditions will permit.

The proposed Report, however, expresses the view that the total stock contemplated by the very limited capitalization permitted by the Bureau Plan should be divided substantially equally between Preferred and Common Stock. The result is that not enough Preferred Stock is permitted to provide for the present bondholders' interest.

This claim for interest, as the proposed Report correctly finds (p. 53), is entitled to the same priority over the claims of other creditors of the Debtor as the principal of the debt, and the quotation from the proposed Report above set forth recognizes the right of the bondholders to receive priority securities for that interest, "at least to the extent that existing conditions will permit."

The Bondholders' Committee submits that there is no necessity for an equal division of the stock capitalization between Preferred and Common and that even if the limited capitalization contemplated by the Bureau Plan is adhered to, the division of the stock should provide a sufficient amount of Preferred Stock to permit the recognition of the bondholders' claim for interest in priority securities. This can do no possible harm to the capital structure in view of the fact already pointed out that dividends not earned on the Preferred Stock do not accumulate and therefore can never constitute a

burden to the Debtor as reorganized or in any way adversely affect its credit. There are no "existing conditions" which do not permit such recognition of the bondholders' rights. [614]

H. The shares of Common Stock to be issued in the reorganization should be without par value as contemplated by the Bondholders' Plan rather than of the par value of \$100 each as provided by the Bureau Plan. (See Exceptions 19 and 24.)

There are wide differences of opinion not only between the Bondholders' Committee and the Bureau but also between the Bondholders' Committee and other creditors and the Western Pacific Corporation, the sole stockholder of the Debtor, as to the aggregate amount at which the properties of the Debtor should be capitalized in reorganization. It would therefore seem advisable to assign no par value to whatever number of shares of Common Stock may be issued in the reorganization to represent the residual value of the property after deducting the par value securities down through the Preferred Stock, rather than to attempt to place an exact dollar mark on the aliquot part of the residue represented by each share.

Quite apart, however, from avoiding unnecessary conflicts of opinion, the use of \$100 par value shares for the Common Stock in the present situation will prevent any reasonable probability that the Common Stock can ever be used as a financing medium.

The Common Stock under both the Bondholders' Plan and the Bureau Plan is to bear \$3.00 a share

dividends after the Preferred dividends and thereafter is to participate with the Preferred Stock on a share-for-share basis. It will require earnings much greater than are now visible for a stock with these dividend rights to attain a market value equal to the par value of \$100 which the Bureau Plan assigns. Under the laws of California, where the Debtor is organized, shares of a railroad corporation can- [615] not be sold at less than their par value. The Bondholders' Committee submits that not only is it compatible with the public interest, but that public interest requires, that the Commission should facilitate, rather than obstruct, the use of Common Stock to provide future financing even though the market may require it to be sold at a price below \$100 per share. This the Commission can do by the very simply expedient of permitting the shares to be without par value.

If the Commission adopts the view of the Bondholders' Committee that sound capitalization permits the creation of sufficient Preferred Stock to cover all of the bondholders' claims, including that for interest, thus obviating the necessity of the use of Common Stock for any part of the bondholders' claims, the Bondholders' Committee does not have any substantial interest in the number of shares into which the common capital is divided. If, however, the Commission does not adopt that view, then problems as to distribution of the common capital, which are hereinafter discussed (*infra*, pp. 47-50), may make advisable an increase in the number of

shares into which the common capital shall be divided. Such an increase, of course, can be made without getting into the question of total dollar valuation if, as suggested, the shares are without par value.

Furthermore, if the Commission, while approving the general framework of the Bondholders' Plan, should feel that the number of shares of Common Stock provided for by the Bondholders' Plan is too large, then, of course, the Bondholders' Plan may easily be modified by reducing proportionately all the allotments of Common Stock which it contemplates. Here again elimination of a par value for the Common Stock will eliminate ground for objection to the ultimate Plan. [616]

I. Contingency Reserve Fund: Capital Fund; and Sinking Fund. (See Exception 25.)

The Bondholders' Plan contemplates a Contingency Reserve Fund, to be maintained at \$500,000, as an emergency fund to take care of lean periods and prevent defaults due to rapidly falling earnings. The Bureau Plan provides for no such fund. The Bondholders' Committee does not feel that such a fund is indispensable.

Both the Bondholders' Plan and the Bureau Plan provide for a Capital Fund to come out of income after fixed charges. The Bondholders' Plan, however, contemplates that the Capital Fund shall be on the basis of annual rests with permissible use of \$500,000 in respect of each year to and including 1940, \$1,000,000 in respect of the years 1940 to

1945, both inclusive, and thereafter at the rate of 3% of consolidated gross revenues. The Bureau Plan, on the other hand, provides a flat Capital Fund to be maintained at \$1,000,000, with an appropriation of not more than \$500,000 in any year.

The Bondholders' Committee believes that the Capital Fund suggested in the Bondholders' Plan is better adapted to the needs of the property than the Capital Fund proposed by the Bureau Plan, particularly in the event of dollar inflation, resulting in rapidly increasing costs, which will have to be offset by increased revenues. The fixing of the Capital Fund at a flat dollar amount under such circumstances might result in an inadequate Fund, whereas the situation would automatically be taken care of under the provision that the Capital Fund shall be a percentage of gross. However, the Bondholders' Committee does not believe this to be a vital point of difference.

The Bondholders' Plan contemplates a Sinking Fund which shall come out of available net income after payment of Preferred dividends, while the Bureau Plan provides that it shall be taken before Preferred dividends. On the other hand, the Sinking Fund provided by the Bondholders' Plan is twice as large as that provided by the Bureau Plan. While again the Bondholders' Committee believes that its proposal is preferable, it does not believe that the suggested change in position of the Fund would constitute an obstruction to consummating a reorganization, assuming that such change

in position were compensated by a reduction in the amount of the Fund as proposed by the Bureau Plan.

### III.

The Bondholders' Plan "affords due recognition to the rights of each class of creditors and stockholders" and "does not discriminate unfairly in favor of any class"; while the Bureau Plan in several respects fails to "afford due recognition" to such rights and in several respects does "discriminate unfairly in favor of" junior creditors and the Western Pacific Corporation, the sole stockholder, and against the present First Mortgage Bondholders. (See Exceptions 6 to 9, 15 to 17, 19 to 22, 26 to 28.)

The proposed Report correctly finds, and the Bureau Plan is correctly predicated upon the conclusion, that the First Mortgage is a first lien upon substantially all the valuable assets of the Debtor. The proposed Report also correctly recognizes that the well-established decisions of the Supreme Court and the lower Federal courts with respect to reorganizations in equity govern the relative treatment of different classes of securityholders in a railroad reorganization under Section 77, and that [618] accordingly the "holders of the Debtor's First Mortgage bonds should receive securities of a higher rank than other creditors, at least to the extent that existing conditions will permit" (p. 52).

The proposed Report, however, fails to recognize the equally well-established rule of law that "to the extent that existing conditions" do not "permit" prior creditors to receive a *qualitative* preference in new securities (i.e., securities ranking in priority as to assets and income over those allotted junior interests) the prior creditors' position must be recognized by a *quantitative* preference (i.e., by giving them securities of the same rank as those given junior interests, but greater in amount per unit of claim or upon more favorable terms). *Kansas City Terminal Ry. v. Central Union Trust Co.*, 271 U. S. 445.

Furthermore, while the proposed Report expressly recognizes the fundamental rule of priority, the Bureau Plan gives it but formal observance. Observance must be in substance and not merely in form. The prior securities allotted to the prior creditors must give to the prior creditors a reasonable opportunity to recoup their investment in priority to the recoupment of the junior investment. The rule would not be complied with, for example, by allotting to prior creditors (here the First Mortgage Bondholders), to use an extreme illustration, non-cumulative contingent interest and dividend securities bearing 2% current return.

The Bondholders' Committee, in the preparation of the Bondholders' Plan, made an earnest and sincere attempt, after thorough consideration, to work out a Plan which would give fair substantive recognition to the rights of each class of creditors and

stockholders of the Debtor, and which would not discriminate unfairly in favor of any class, even the First Mortgage Bonds. The affirmative [619] arguments in support of the Bondholders' Plan in that respect will be found at pages 81 to 92, inclusive, of the January, 1937, brief of the Bondholders' Committee. Those arguments seem to go wholly unanswered in the proposed Report, the Bureau apparently treating them as irrelevant in view of the fact that its conception of the future earning power of the Debtor resulted in the reduction of capitalization and the restriction of security rights already discussed.

The failure of the Bureau Plan to comply with the requirements of Section 77 with respect to the recognition of the rights of the relative classes of securityholders arises very largely out of this unnecessarily drastic view of the permissible capital structure. However, were such a view well founded, the resultant damage to existing securityholders should fall in much less degree on First Mortgage Bondholders, and in much greater degree upon junior securityholders, than is provided by the Bureau Plan.

A. The terms upon which the Bureau Plan proposes to raise new money unfairly discriminate in favor of Western Pacific Corporation (perhaps RCC) and against the First Mortgage Bondholders. (See Exception 26.)

As already pointed out, the Bureau Plan denies to the present First Mortgage Bondholders any par-

ticipation in fixed charges or in the new First Mortgage in order to permit the creation of new First Mortgage Bonds so limited in amount in relationship to both assets and earnings of the Debtor that the bonds themselves are clearly worth more than par, and then for the wholly unfounded reason of insuring their sale at par, couples with the \$10,000,000 of such new First Mortgage Bonds 100,000 shares of new Common Stock (representing one-third of the entire common capital) and offers this "package" to [620] the Western Pacific Corporation at a price lower than the worth of the bonds alone.

The Bureau Plan purports to allot the offer to the Western Pacific Corporation, not in its capacity as a stockholder, but in its capacity as an unsecured creditor, for \$7,188,607. The proposed Report then adds the further statement (p. 56) "The provision for the participation by the unsecured creditor would not discriminate either against the First Mortgage Bonds or the other secured creditors because such unsecured creditor must contribute \$1,000 in cash for each \$1,000 bond and 10 shares of new Common Stock received."

It is a strange conception that the payment of \$1,000 for a bond worth more than \$1,000 *plus* a share in the equity both potentially and actually presently valuable is any *contribution* at all. The result is that the creditor lowest in rank, which is also the sole stockholder of the Debtor, upon buying bonds worth more than the price paid, receives

Common Stock for its claim at the rate of \$139 for each \$100 of its claim—while the Bureau Plan at the same time proposes that the bondholders shall receive Common Stock for their concededly prior interest at the rate of \$100 in Common Stock for each \$100 interest and purports to allot to the junior secured creditors (RFC, RCC and ACJ) Common Stock in the aggregate at the rate of \$100 for each \$100 of such junior claims.

This is on its face an unfair discrimination in favor of the Western Pacific Corporation.

The problem is, however, complicated by the fact that the claim in respect of which the Bureau Plan purports to permit this Western Pacific Corporation subscription to new money has been assigned to RCC as collateral for the RCC note (Ex. 9). If, therefore, the subscription right constitutes an additional participation of RCC in the [621] reorganized Debtor, it constitutes a discrimination in favor of RCC and against the bondholders.

In Appendix C to the January, 1937, brief of the Bondholders' Committee, there was set forth a detailed study of the new securities which had been issued to provide new money in every major railroad reorganization from 1894 to 1936. That study evidenced the fact that in no previous reorganization has new money been given such favorable terms as are proposed by the Bureau Plan, whether the new money was furnished by stockholders or by junior creditors. Yet many of those reorganizations have been severely criticized by responsible learned

authorities on reorganization problems as unduly favorable to the junior interests which were given the subscription rights there involved. See Moulton and Associates, *The American Transportation Problem* (1933), pp. 336-348.

The only justification for permitting junior interests to participate in such a reorganization as is here involved is that they may afford a market which will take securities at a higher price than they could otherwise be sold in the hope of preserving existing investments. The bonds offered to provide new money, if offered to the junior interests, whether in their capacity as stockholders or junior creditors must therefore be securities which are at least not worth substantially more than the price at which they are offered. It is in the difference between the lower market value of the new money securities and the higher price paid that justification can be found for permitting junior interests to retain a position in the reorganized property when drastic sacrifices of the character here tendered in the Bondholders' Plan are accepted by the bondholders.

There is in the record no evidence to support the implication of the proposed Report that the First Mortgage Bonds which it proposes require any bonus to effect their [622] sale at par. Whatever evidence there is in the record on this subject is to the contrary. The First Mortgage Bonds proposed for new money under the Bondholders' Plan are part of substantially twice as large an issue as is

contemplated by the Bureau and therefore, as already pointed out, have substantially less, although still "adequate", coverage by "earnings experience" and "probable prospective earnings." Yet counsel for the Bondholders' Committee stated both orally and in the January, 1937, brief that it was the belief of the Bondholders' Committee that those bonds were saleable at substantially par.

The Commission has an ample fund of practical knowledge of this sort of problem to know, without more evidence, that the bonds proposed by the Bureau Plan are in fact worth more than par and do not require any such bonus. The Bureau Plan therefore creates a substantial gift to the Western Pacific Corporation (or its assignee) at the expense of the First Mortgage Bondholders in violation of "the law of the land."

The Bondholders' Committee believes that this problem should be dealt with as provided in the Bondholders' Plan, which gives to the Western Pacific Corporation an opportunity to preserve an interest in the equity, but upon terms which do not grossly discriminate in favor of the Western Pacific Corporation and against the First Mortgage Bondholders.

In this connection, it should be pointed out that the successive offerings of the new money "package" to the junior creditors and then to the First Mortgage Bondholders, provided for in the Bureau Plan, is wholly illusory and ineffective. These successive offerings, under the Bureau Plan, are upon

exactly the same terms as the offering to the Western Pacific Corporation. The [623] purpose of such successive offerings is to insure the provision of the new money if it is not provided upon the prior offerings. The only possible reason for the failure of a prior offering would be that the securities offered were not worth the offering price. It is therefore a futile gesture to make an offering of the already rejected securities, upon no better terms, to the senior interests.

This latter problem was taken care of in the Bondholders' Plan by providing an original offering to the Western Pacific Corporation upon terms which were believed would make the "package" worth approximately the offering price, but improving the terms to each successive offeree. Under such an arrangement, if the market did not justify the Western Pacific Corporation in accepting the offering, then the better terms of the offering to RFC, RCC and ACJ would, it was believed, make the offering attractive to those offerees. If, however, market conditions were so adverse as to make that offering not attractive, then the terms were improved in order to make it attractive to the First Mortgage Bondholders. To safeguard against the possible contingency that not even this offer would be adequate to induce the First Mortgage Bondholders to provide the new money, the Bondholders' Plan provided for an underwriting, subject to the approval of the Commission and the Court, and also permitted adjustment of the rate upon the new

First Mortgage Bonds to be offered, in the light of market conditions existing at the time of the actual offer. These provisions the Bondholders' Committee believes are wise and fair and should be adopted by the Commission. However, their elimination would not be fatal to acceptance of the Plan.

The terms upon which the Bureau Plan proposes to offer the new money First Mortgage Bonds and bonus [624] Common Stock contain another unfair discrimination which, although it involves only a small amount and does not directly affect the bondholders, should be remedied by the Commission in order to obviate the vulnerability of the ultimate Plan to justifiable attack. The Bureau Plan provides that the new money "package" shall be offered to the Western Pacific Corporation as an unsecured creditor, and then adds (p. 55) "The claim of the Western Realty Company should be canceled." The unsecured claim of the Western Realty Company ranks *pari passu* with that of the Western Pacific Corporation. The Western Realty Company is therefore entitled to participate ratably with the Western Pacific Corporation in accordance with the amounts of their respective claims. While the Western Realty Company stock is wholly owned by the Western Pacific Corporation, counsel is advised that it has been pledged to Curtis Southwestern Corporation. This provision of the Bureau Plan, therefore, is a violation of Section 77 as against Western Realty Company and the pledgee of its stock. This defect, of course, is purely formal and not substan-

tive, and can be remedied by providing that any offering to unsecured creditors shall be proportionately to the Western Pacific Corporation and to the Western Realty Company. While the January, 1937, brief of the Bondholders' Committee indicated that it was the intent of the Bondholders' Plan that the offering to the Western Pacific Corporation covered, and should be allocated to, the unsecured claims of both the Western Pacific Corporation and the Western Realty Company, the Bondholders' Plan is itself not sufficiently clear on this point and should be modified to obviate the risk here pointed out.

[625]

B. The Bureau Plan unfairly discriminates in favor of RFC, RCC and ACJ, and also in favor of Western Pacific Corporation, and against the First Mortgage Bondholders by allotting to these junior interests new Common Stock at a higher rate per \$100 of claim than is allotted to the bondholders for their prior claim for interest. (See Exception 27.)

The proposed Report correctly finds that the bondholders' position, including their claims for interest, is entirely prior to the position of all the junior creditors, secured and unsecured (pp. 46-49, 52-53). As already pointed out, this priority should be maintained in the reorganization through a *qualitative* preference of the new securities allotted to the bondholders in respect of their interest. This claim, therefore, should be recognized in new Preferred Stock.

If, as the bondholders believe is not at all the case, the situation does not so permit, but requires that the bondholders shall accept Common Stock for the part of their claim represented by interest, then "the law of the land" requires a *quantitative* preference, viz. that the Common Stock so allotted shall be at a rate per \$100 of the interest claim greater than the rate per \$100 of claim at which Common Stock is allotted to junior creditors. No amount of multiplication of collateral junior to the First Mortgage Bonds can result in raising the junior RFC Note, RCC Note and ACJ Note or the unsecured claims of the Western Pacific Corporation to a position, as to each \$100 of the claims, of equality with, or priority to, the bondholders' prior claim for interest.

Yet, the Bureau Plan, while giving to the bondholders new Common Stock at the rate of \$100 par value for each \$100 of the claim for interest, gives to the RFC Note new [626] Common Stock at the rate of \$198 for each \$100 of that claim as of January 1, 1937, and to the RCC Note new Common Stock at the rate of \$96 for each \$100 of its claim, exclusive of anything which it may get as assignee of the Western Pacific Corporation's unsecured claim, and if the rights of RCC as such assignee are included, Common Stock at the rate of \$481 for each \$100 of the claim represented by the RCC Note. It also gives to Western Pacific Corporation as an unsecured creditor \$139 new Common Stock for each \$100 of its unsecured claim.

If the Commission will allot Preferred Stock for the bondholders' interest, then the Bondholders' Committee has no interest in the question as to how much stock is allotted to the junior creditors within the limits of the Bondholders' Plan or as to the distribution of that stock among those creditors, except its interest that the Plan shall be valid, and, therefore, not subject on its face to rejection by the Court.

If, however, Common Stock is to be issued for the bondholders' interest, then no Plan can comply with "the law of the land" which does not give to the bondholders for their interest Common Stock on more favorable terms per \$100 of claim than are given to any class of junior creditors. The most favorably situated junior creditor is RFC. If, therefore, RFC is to receive approximately 2 shares of new Common Stock for each \$100 of its claim, the First Mortgage Bondholders must be given more than 2 shares of Common Stock for each \$100 of their claim for interest. On the other hand, if the bondholders are to be required to accept 1 share of new Common Stock, for each \$100 of their interest claim, then RFC must be allotted something less than 1 share, of new Common Stock for each \$100 of its claim. [627]

And since RFC, RCC and ACJ must, as the proposed Report correctly finds, participate as among themselves in proportion to their collateral, the participations allotted to RCC and ACJ in respect of their Notes must be proportionately less than the

participation allotted to RFC. Again, let the Bondholders' Committee repeat that if the bondholders are removed from this discrimination by the issue of Preferred Stock for their interest claims, they have no interest in any discrimination as between the junior creditors provided the junior creditors agree among themselves so that no one of them can make the discrimination the basis for an attack on the Plan.

The relationships between RFC, RCC and ACJ are extremely complicated, as pointed out in the January, 1937, brief of the Bondholders' Committee (pp. 7, 85-87). It was to meet those complications in a manner which would not give any one of those parties the basis for an attack upon the Plan that the Bondholders' Plan provided the device of escrow certificates, which exactly recognize the relative rights of those three parties inter se as well as the ultimate right of redemption of the Western Pacific Corporation. Those provisions have been criticized as unduly complicated by counsel for some of the junior creditors concerned. Counsel for the Bondholders' Committee recognize the complicated character of the provisions, but point out that (in the absence of agreement among the junior creditors) that complication is necessitated by the very complication of the relationships. The Bondholders' Committee would be glad indeed to have the provisions for escrow certificates eliminated if any way can be found for such elimination, without simultaneously opening up a well-founded basis for at-

tack on the Plan by the very counsel who utter the criticism. [628]

C. The limitations imposed by the Bureau Plan upon total First Mortgage Bonds, total Preferred Stock, rates of annual return on Income Bonds and Preferred Stock, and accumulation of Income Bond interest, taken together, impose such sacrifices upon the present First Mortgage Bondholders, all of which ultimately redound to the benefit of the new Common Stock, as to constitute an unfair discrimination against the First Mortgage Bondholders and in favor of RFC, RCC, ACJ and the Western Pacific Corporation as the principal recipients of the new Common Stock.

Each of these limitations and its result has already been separately discussed in the discussion of the proposed capital structure. Each one is serious, but taken in the aggregate, their cumulative effect ~~is~~ to destroy any possibility that the bondholders will ever recoup their investment, while at the same time creating and granting to junior interests new Common Stock which, not suffering in lean years but profiting in prosperous years, will have substantial value.

The participating feature of the New Preferred Stock is important if the bondholders are adequately to be compensated for these sacrifices which the Bureau plan imposes upon them. However, in the light of the Bureau's views of future earnings the possibility of such participating feature ever

becoming effective is so remote as not adequately to compensate the bondholders for such sacrifices.

D. The Bureau Plan discriminates unfairly against the present bondholders in favor of junior interests in granting to each share of Common Stock equal voting power with each share of Preferred Stock in the election of directors. (See Exception 22.)

This discrimination has already been adequately discussed (*supra*, pp. 32-34.) [629]

E. The Bureau Plan unfairly discriminates against the First Mortgage Bondholders in providing that the reorganization shall be effected, and the details of its carrying out determined, by a committee controlled by junior interests. (See Exceptions 28 and 31.)

As pointed out in the January, 1937, brief of the Bondholders' Committee (p. 91), and as recognized by the proposed Report (p. 58), it is impractical and would be unduly confusing to prescribe in the reorganization plan all the details of the reorganization. Accordingly, many of those details must be left to some representatives of the securityholders.

On the other hand, fair dealing with the securityholders requires that as many as possible of the important substantive points involved in the reorganization should be worked out and specified in the Plan. Recent Federal legislation, and recent regulations and reports issued by the Securities and Exchange Commission, have been concerned with in-

sure full disclosure to prospective purchasers of securities of the rights which those securities will have. The Bondholders' Plan accordingly endeavored to work out, in much greater detail than either the Debtor's Plan or the James Plan, specific definitions of the rights of the proposed new securities. The Bureau Plan seems lacking in specification on important substantive points. To obviate any justifiable basis for such a criticism of the ultimate Plan, the Bondholders' Committee urges that before the Commission publicly announces the Plan which it will approve, it give to all the interested parties an opportunity to confer with its representatives and work out the provisions of the ultimate Plan in sufficient detail to make to the securityholders an adequate disclosure of what they are voting upon. Legal [630] and financial documents, which are necessarily somewhat complicated, cannot well be drafted in formal public hearings.

But even when the ultimate Plan is worked out with reasonable specification, many details will remain for determination in the course of the consummation of the reorganization. This determination the Bondholders' Plan committed to the Bondholders' Committee itself in view of the paramount interest of the bondholders in the property. The Bureau Plan, however, commits the determination of these questions to a committee of three, one nominated by the Bondholders' Committee; one by RFC, RCC and ACJ as a group, and one by the Western Pacific Corporation.

The proposed Report finds that the Western Pacific Corporation's holdings of Preferred and Common Stock of the Debtor have no value and are entitled to no participation. The Western Pacific Corporation's claim as an unsecured creditor has been pledged to RCC. The anomalous result is thus produced that one of the three members of this reorganization committee will be the nominee of a party which will have no interest whatsoever in the reorganized property. If, as may be claimed by RCC, this right of nomination attaches to the unsecured claim which the RCC holds as pledgee, the equally anomalous result will follow that two of the three members of the proposed committee will represent a group of junior creditors, to whom, under the provisions of the Bureau Plan itself, there is allotted only a minority of the voting stock of the reorganized Debtor.

The members of the Bondholders' Committee have no personal desire to perform the work of a reorganization committee, and they have no objection to representation on the reorganization committee of the junior creditors, or even of the Western Pacific Corporation, if it provides [631] the new money on proper terms. The Bondholders' Committee cannot, however, recommend to the bondholders acceptance of any Plan on which representatives of the First Mortgage Bondholders, chosen as the Commission may determine, shall have less than a majority of the membership.

## IV.

Any Plan which the Commission may approve should contain a provision, permitted by subsection (b) (5) of Section 77, for the protection of dissenting classes of the Debtor's securityholders by "the sale of all \* \* \* the property of the Debtor \* \* \* at not less than a fair up-set price" and "the distribution of \* \* \* the proceeds derived from the sale thereof, among those having an interest therein." (See Exceptions 29 and 30.)

The Bondholders' Plan contained provisions (1) requiring the consent of two-thirds of the bondholders as a condition precedent to the confirmation of the Plan, and (2) requiring as to any other class of securityholders as to which less than the statutory two-thirds assents, the sale of the property of the Debtor at a fair up-set price, the use of all assenting securities in the purchase of such property, and the distribution of the proceeds of such sale to the dissenting securityholders of the dissenting classes in accordance with their interests therein.

The proposed Report rejects, and the Bureau Plan omits, both provisions.

For the reasons set forth in the January, 1937, brief of the Bondholders' Committee, it is believed that the first of these provisions is wise, that its inclusion will facilitate [632] rather than obstruct a reorganization, and that any attempt to exercise the coercive power purported to be granted by Sec-

tion 77 can only result in long litigation and indefinite delay in the reorganization. Counsel for the Bondholders' Committee have advised that in their opinion this coercive provision is unconstitutional as against dissenting members of a dissenting class, unless that class is otherwise protected as hereinafter suggested. The Bondholders' Committee, however, does not, at this time, press further its point as to the first of the omitted provisions.

However, the Bondholders' Committee believes that unless the second of the suggested provisions is included in any Plan which the Commission may approve and, the first provision having been omitted, the second provision is also extended to cover the bondholders as a possible dissenting class, the practical situation in the Western Pacific case will make impossible any reorganization without interminable litigation, if not entirely prevent reorganization.

It also believes that if the Commission takes the construction of Section 77 which the proposed Report has taken, the most severe condemnation of the critics of Section 77 as to its unworkability will have been confirmed by the Commission.

The provision purporting to give the Commission and the Court the power to force a Plan upon a class of creditors, particularly mortgage bondholders, which as a class has dissented from the reorganization, would seem to be clearly unconstitutional under the decisions of the United States.

Supreme Court. *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555. See also: *In re Tennessee Publishing Co.*, 81 F. (2d) 463; *Continental [633] Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co.*, 294 U. S. 648.

Even if the Commission does not agree with this conclusion, it would seem wise that the Commission should not adopt a construction of Section 77 which raises a doubt as to the constitutionality of the procedure attempted to be taken in the reorganization.

Furthermore, the compulsory provision itself does not permit the exercise of the power of coercion purported to be granted unless the Court finds that such rejection (i. e., by the dissenting class) "is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relative facts". The rejection of a Plan by more than one-third of the bonds (and the Bureau Plan in anything like its present form would be so rejected) is strong *prima facie* evidence that the Plan is not fair or equitable and that the rejection is reasonably justified. This fact alone would seem to make advisable in the public interest the inclusion of a constitutional method of fixing the rights of the dissenting members of a class which, as a class, dissents by failing to give the statutory two-thirds assent.

The proposed Report rejects the argument of counsel for the Bondholders' Committee that sub-

section (b) (5) expressly authorizes the inclusion of the suggested provision providing for the protection of the dissenting members of a dissenting class through a sale at a fair up-set price. The only argument contained in the proposed Report for its conclusion is that Section 77 contemplates "that reorganization shall be accomplished through confirmation of a Plan, or that the proceedings should be dismissed." To the fact stated in that argument counsel for the Bondholders' Committee do not at all dissent. Of [634] course the Plan must be confirmed. But when it is confirmed (under the coercive provision of Section 77 if any class dissents), one of the provisions of the confirmed Plan should be the suggested and expressly authorized "means for the execution of the Plan", viz., "the sale of all \* \* \* the property of the Debtor \* \* \* at not less than a fair upset price", for the protection of the dissenting class. If, at such sale, the property is purchased by assenting classes, the reorganization will proceed with the issue of securities contemplated by the Confirmed Plan. If, on the other hand at such sale, the property is purchased by a dissenting class, the assenters will, under this provision of the Confirmed Plan, receive their proportionate part of the proceeds of sale. The dissenters in the latter case will own the property and will have to recapitalize it in accordance with Section 20(a) of the Transportation Act. Thus, as to non-assenting members of non-assenting classes, the unconstitutional features of the coercive provision will

have been obviated by providing for them a conventional and clearly constitutional means of realizing the value of their interest in the Debtor's property. Failure to include this provision will destroy the validity of any plan; its inclusion will save the Plan.

An examination of the legislative history of the 1935 amendments to Section 77 will show that this provision of sub-section (b) (5) was inserted for the express purpose of dealing with the constitutional question raised by the inclusion of the coercive provision and for the purpose of enabling those who desire to have a reorganization which will vest marketable title in the reorganized property and validate the securities which may be issued in the reorganization, to have a means of so doing by a judicial sale of the sort here suggested. What "sale of all the property of the Debtor \* \* \* at not less than a fair up-set price" [635] could there possibly be, under a confirmed Plan, other than a sale of the sort contemplated by this provision of the Bondholders' Plan?

Any other construction of sub-section (b) (5) will leave subsection (b) (5) wholly without meaning, and it is a fundamental rule of construction that even as between two apparently conflicting provisions of any Act, effect must be given to both to the extent that such effect can be given. Even if sub-section (b) (5) and the provisions respecting confirmation of a Plan have any apparent conflict (which it is submitted they do not have), effect can

be given to each of the provisions by taking the construction urged by the Bondholders' Committee.

## V.

Summary of modifications in the Bondholders' Plan acceptable to the Bondholders' Committee.

Throughout this brief various suggestions have been made as to modifications which might be made of the Bondholders' Plan to meet criticisms which are made, or to be implied, from the proposed Report. It may clarify the Commission's dealing with the problem if those modifications are summarized.

That the Bondholders' Committee indicates these possible modifications is not to be taken as any indication either that the Bondholders' Committee believes that they are wise, or even justified, or that the Bondholders' Committee believes that with them the acceptance of the Plan by the bondholders will not be materially more difficult to obtain.

If the Commission after weighing all the arguments in its judicial capacity decides that the following modifica- [636] tions of the Bondholders' Plan are necessary, the Bondholders' Committee is desirous of cooperating to facilitate the reorganization and, accordingly, would recommend the acceptance of the plan with such modifications:

1. Open the Income Mortgage to provide for future financing through Income Bonds.
2. Reduce the dividend rate upon the Preferred Stock from 6% to 5%.

3. Eliminate the provision giving the Preferred Stock power to elect a majority of the Board of Directors.

4. Reduce the number of shares of Common Stock to such number as the Commission may require, provided that the distribution of such shares shall remain in the proportions provided in the Bondholders' Plan.

5. Eliminate the Contingency Reserve Fund.

6. Make the Sinking Fund payable out of available net income before Preferred dividends, but, as provided in the Bureau Plan, reduce it to an annual  $\frac{1}{2}$  of 1% Fund instead of a 1% Fund.

7. Change the provision for the Capital Fund to the provision contained in the Bureau Plan.

8. Clarify the provision respecting the offering of new securities to provide new money by providing that it shall be made to the unsecured creditors (i. e., the Western Pacific Corporation or its assignee, and the Western Realty Company) proportionately to the amounts of their respective claims.

9. Eliminate the provision for successive offerings of the new money First Mortgage Bonds and [637] bonus Common Stock successively to the junior secured creditors and the First Mortgage Bondholders, upon progressively more favorable terms to the offeree, and

also the provision for ultimate underwriting; and substitute a provision that the exact terms of the offering as to both the interest rate to be borne by the new money First Mortgage Bonds and the amount of Common Stock to be included as a bonus shall be determined by the reorganization committee with the approval of the Commission and the Court at the time the offering is to be made, and shall be such that the "package" will be worth approximately the par of the First Mortgage Bonds.

10. Eliminate the provision for escrow certificates, so that RFC, RCC and ACJ will directly receive Common Stock. This modification, however, is unwise unless all these creditors agree upon the distribution of the new Common Stock as among themselves.

11. Provide that the reorganization committee shall be constituted of such number of members, not more than 5, as the Commission may determine, but a majority of whom shall be elected by the bondholders in any manner which the Commission may prescribe.

12. Eliminate the provision requiring the consent of two-thirds of the bondholders to the confirmation of the Plan, but extend the provision for protecting a dissenting class through a judicial sale at a fair up-set price to include the bondholders as a class. [638]

## VI.

In view of the great importance of the principles involved in this proceeding, not only with respect to the investment of institutional bondholders in the Western Pacific, but also with respect to railroad reorganizations generally, oral argument before the full Commission is requested by the Bondholders' Committee.

Respectfully submitted,

CRAVATH, DE GERSDORFF,  
SWAINE & WOOD,

Attorneys for Frederick H. Ecker, John W. Stedman and Reeve Schley, as a Committee as aforesaid, 15 Broad Street, New York, N. Y.

ROBERT T. SWAINE,

LITTLETON GROOM,

Of Counsel. [639]

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EXCEPTIONS OF BONDHOLDERS' COMMITTEE TO PROPOSED REPORT OF THE BUREAU OF FINANCE.

The Bondholders' Committee hereby makes and presents the following exceptions to the Report proposed herein by the Bureau of Finance:

1. The Report errs in its recommendation (p. 38) that the Commission should not approve the debt structure proposed in the Bondholders' Plan as compatible with sound financing and the public interest.

2. The Report errs in not recommending that the Bondholders' Plan, including the debt structure provided for therein, be approved by the Commission as complying with all the requirements of Section 77 and as being compatible with the public interest.

3. The Report errs in recommending (pp. 59-61) a Plan of Reorganization for the Debtor providing for a total capitalization and for new securities of a character not compatible with the public interest and not permitting due recognition of the rights of each class of securityholders.

4. The Report errs in its recommendation (pp. 44, 46) that the capitalization of the reorganized company should be limited to \$91,406,510 par value of securities.

5. The Report errs in not recommending approval by the Commission of the capitalization of the reorganized company contemplated by the Bondholders' Plan.

6. The Report errs in its recommendation (pp. 39-40) that fixed interest-bearing bonds issued in the reorganization be limited in aggregate principal amount of \$10,000,000 "and that no other fixed interest obligations be permitted". [640]

7. The Report errs in failing to recommend that new First Mortgage Bonds be allotted to the present First Mortgage Bondholders for a portion of their claim.

8. The Report errs in its conclusion (p. 39) that no fixed charges in excess of \$500,000 should be authorized or approved.

9. The Report errs in not recommending approval by the Commission of the aggregate fixed charges contemplated by the Bondholders' Plan.

10. The Report errs in its analysis (pp. 19-22) of the Debtor's "earnings experience" and of the "probable prospective earnings" of the reorganized company.

11. The Report errs in its essential conclusion that the First Mortgage Bonds contemplated by the Bondholders' Plan, together with the shares of stock included therewith, would not be salable at par of the bonds.

12. The Report errs in its recommendation (p. 52) that "10 shares of new common stock be given to the purchaser of each \$1,000 principal amount of new bonds", proposed in the Bureau Plan in order "to facilitate the sale of the bonds at par".

13. The Report errs in its recommendation (pp. 42-43) that the total of fixed and contingent interest charges plus sinking fund requirements and the capital fund of the reorganized company should not be more than the earnings of the Debtor available for interest in 1936.

14. The Report errs in not recommending that, in view of the Debtor's earnings experience and probable prospective earnings, the total fixed and contingent interest charges contemplated by the

Bondholders' Plan be approved as compatible with the public interest. [641]

15. The Report errs in recommending (pp. 43, 59) the issuance to present First Mortgage Bondholders of new Income Mortgage Bonds which are not of a character compatible with the public interest or permitting due recognition of the priority rights of the present First Mortgage Bondholders.

16. The Report errs in recommending (p. 43) that the annual interest rate on the Income Mortgage Bonds shall be 4%, and in failing to recommend approval by the Commission of a rate of 5% as contemplated in the Bondholders' Plan.

17. The Report errs in recommending (pp. 41, 43) that interest on the new Income Mortgage Bonds shall be noncumulative determined on semi-annual rests ending June 30 and December 31 in each year.

18. The Report errs in not recommending that interest on the Income Mortgage Bonds shall be cumulative as against three years income, as provided in the Bondholders' Plan.

19. The Report errs in its conclusion (p. 44) that the maximum amount of new Preferred and new Common Stock to be issued in the reorganization may not exceed 295,740  $\frac{3}{5}$ ths shares and 300,682  $\frac{1}{5}$ th shares, respectively, of a value of \$100 each.

20. The Report errs in not recommending that the amounts and character of the Preferred Stock and Common Stock contemplated by the Bond-

holders' Plan be approved by the Commission as compatible with the public interest.

21. The Report errs in recommending (pp. 44-45) Preferred Stock bearing a dividend rate of 5% and in failing [642] to recommend approval by the Commission of a rate of 6% as contemplated in the Bondholders' Plan.

22. The Report errs in recommending (p. 46) that each share of Preferred Stock have equal voting power with each share of Common Stock and in failing to recommend that the Preferred Stock be given the right to elect a majority of the Board of Directors of the reorganized company as contemplated in the Bondholders' Plan.

23. The Report errs in its recommendation (p. 53) that the unpaid interest on present First Mortgage Bonds be commuted into new Common Stock and in failing to recommend that such interest be commuted into Preferred Stock as contemplated in the Bondholders' Plan.

24. The Report errs in recommending (p. 44) that the new Common Stock should be of a par value of \$100 each and in failing to recommend that such stock should be without par value as contemplated by the Bondholders' Plan.

25. The Report errs in its recommendations (pp. 40-42) respecting (1) Contingency Reserve Fund; (2) Capital Fund; and (3) Sinking Fund, and in failing to recommend the approval by the Commission of the provisions of the Bondholders' Plan respecting such funds.

26. The Report errs in recommending a Plan which provides for the raising of new money on terms discriminating unfairly in favor of The Western Pacific Railroad Corporation and against the present First Mortgage Bondholders.

27. The Report errs in recommending a Plan which discriminates unfairly in favor of the junior creditors and against the First Mortgage Bondholders by allotting [643] to the junior creditors new Common Stock at a higher rate per \$100 of claim than that allotted to the present First Mortgage Bondholders for their prior claim for interest.

28. The Report errs in its recommendation (p. 59) as to the constitution of the Reorganization Managers and in failing to recommend approval by the Commission of the provisions respecting Reorganization Managers contained in the Bondholders' Plan.

29. The Report errs in its conclusion (p. 57) that the provision of the Bondholders' Plan requiring its acceptance by or on behalf of the holders of at least two-thirds in principal amount of the First Mortgage Bonds of the Debtor is not in accordance with the provisions of Section 77, and in failing to recommend that such provision be approved by the Commission.

30. The Report errs in its conclusion (p. 58) that the provision of the Bondholders' Plan providing for the sale of the property of the Debtor in case of failure to obtain necessary assents is not in accordance with the provisions of Section 77 and

in failing to recommend that such provision be approved by the Commission as being not only in accordance with the provisions of Section 77, but expressly permitted and contemplated by subsection (b)(5) of Section 77.

31. The Report errs in recommending a Plan which fails to set forth many important substantive points with sufficient detail to enable security-holders to know on what they are voting.

[Endorsed]: Filed Oct. 5, 1939. [644]

Before the Interstate Commerce Commission  
Finance Docket No. 10913.

In the Matter of THE WESTERN PACIFIC  
RAILROAD COMPANY, Debtor.

THE RAILROAD CREDIT CORPORATION,  
Intervening Petitioner.

#### PETITION FOR MODIFICATION

To the Interstate Commerce Commission:

The Railroad Credit Corporation (hereinafter referred to as the R.C.C.), an intervenor in the above entitled proceeding, respectfully petitions the Interstate Commerce Commission under the provisions of Subsection (d) of Section 77 of the Federal Bankruptcy Act as amended, to modify its Report and Order herein dated October 10, 1938, as set out in Paragraph A of this petition, or alternatively as suggested in Paragraph B hereof, and in support of said petition represents:

**A**

That the Report and Order herein of the Interstate Commerce Commission, dated October 10, 1938, err in material respects, both in fact and in law, and do not conform to the requirements of Section 77 of the Federal Bankruptcy Act as amended, and should be modified, as hereinafter set forth:

1. Paragraph A of said Order directs that the effective date of the plan reported in said Order (hereinafter referred to as the I.C.C. Plan) shall be July 1, 1938.

The employment of an arbitrary effective date earlier than the actual date of reorganization would result in the payment of interest upon interest that [646] has accrued during the pendency of the Section 77 proceeding, in a case where, as in the Western Pacific, new bonds are to be issued in satisfaction of existing bonded indebtedness. While it is doubtless proper to fix an arbitrary cut-off date for the purpose of determining relative amounts of claims as of such date, an arbitrary effective date can not be so employed as to affect substantive rights. Even an approved and confirmed plan can not act upon substantive rights retroactively. No plan has yet been approved or confirmed herein. It is possible that no plan ever will be approved and confirmed in this proceeding. Pending the final adoption and consummation of a plan, or other disposition of this proceeding, the R.C.C., in pursuance of a substantive right, has applied,

and it has a duty to apply in future, income and proceeds of collateral to or towards the payment of the principal of or interest upon the debt secured, in accordance with the principles twice declared by District Courts of the United States in proceedings under Section 77 of the Federal Bankruptcy Act as amended, to which proceedings the R.C.C. was a party and in which its rights, as herein discussed, were in issue (New Haven Reorganization, printed record p. 2903; St. L. S. W. Reorganization, printed record p. 3533). The rights of the R.C.C. in this respect are not dependent upon the action of any court but exist by virtue of the general law of pledges and the guarantees of the Fifth Amendment to the Constitution. (See also *The Railroad Credit Corporation v. Hawkins*, 80 F. (2d) 818; cert. den. 298 U. S. 667). The R.C.C. has a positive duty to apply such income and proceeds as aforesaid; such funds, when so applied, become the property of the R.C.C. subject to the terms and provisions of the Marshalling and Distributing Plan, 1931, and are distributed by the R.C.C. from time to time in accordance with said terms and provisions. The R.C.C. cannot be required to suspend the performance of its duties under said Marshalling and Distributing Plan, 1931, on the chance [647] (uncertain of fulfillment) that any particular plan will ultimately become effective. The alternative, under the I.C.C. Plan, would seem to be an order directing the R.C.C., upon the actual effective date, which may be years hence if it does occur, to return funds which

it has received as income or proceeds, applied on the debt secured, and distributed to the participating carriers under said Marshalling and Distributing Plan, 1931. Manifestly such an order, if issued, would not be sustained on appeal. It is significant that the loans made by the R.C.C. to the Debtor, and upon which the R.C.C.'s claim herein is based, were made prior to the enactment of said Section 77.

The I.C.C. Plan should either omit all references to an arbitrary effective date, or include the provision hereinafter proposed under subparagraph 7.

2. Paragraph C of said Order directs that the capitalization shall be an aggregate sum of \$93,726.517 (treating no-par-value common stock at \$100 per share).

The Report states (sheets 40-41), "It will be observed that insofar as the capitalization of a reorganized company is concerned, Section 77 contains no limitations other than that the fixed charges of the company shall be adequately covered by the probable earnings available therefor; and the plan as a whole shall be compatible with the public interest. The public interest is not defined, but it would seem obvious that to be compatible with the public interest, the plan must provide a capital structure for the reorganized company which will give it a reasonable opportunity to function efficiently and continuously as a going concern. This requires that the capitalization should not exceed a conservative appraisal of the assets to be taken over by the re-

organized company, and that proposed charges, whether fixed or contingent, be within the probable earning power." (Italics supplied). [648]

Again, at sheets 51-52, the Commission's Report says, "It is obvious, therefore, that based on the most optimistic estimate of earnings of record, the capitalization of the reorganized company must be maintained within strict limits if any material return on its capital stock is to be expected and the shares of its stock are not to become mere tokens for stock market speculation. It is true that considered alone, the data pertaining to the rate-making value of the debtor's property, and its investment, would support capitalizations approximating those proposed in the three plans" (viz. \$74,270,738, exclusive, of no par stock, to \$124,259,367, inclusive of such stock taken at \$100 per share).

Mr. Commissioner Miller in a partly dissenting opinion said (sheet 72), after quoting the sentence last above quoted, "With this conclusion I can not agree but am strongly of the view that the capitalization should be generally on the basis of original cost less depreciation amounting to something over \$120,000,000, which is about the same as is proposed in two of the three plans referred to in the above quotation. The no-par-value common stock may have little or no market value when the company is reorganized, but the issuance in the neighborhood of \$30,000,000 more than the majority authorize would give the present stockholders a chance to participate in the future profits of the reorganized company."

There is no practical or legal necessity for taking the no-par-value stock at \$100 per share in computing capitalization—to do so is only to run up the *apparent* capitalization. It would be more accurate to treat it in this instance as having a merely nominal value, which would leave the capitalization at its real level, under the I.C.C. Plan, of roundly \$63,000,000.

It may generally be in the public interest (though the point is not without doubt, because of the strong arguments *contra*) that capitalization should be based on a "conservative appraisal" and kept "within strict limits"; but even if this be true, in this instance, these tests should not be so applied as to [649] destroy property rights. The Supreme Court said in *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555 (1935), " \* \* \* the Fifth Amendment commands that, however great the Nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest, may be borne by the public." Assets of the Debtor may not be diverted or withheld from those entitled to them, whether creditors or stockholders.

The R.C.C. holds in pledge, among other items of collateral, certain bonds of the Debtor. Although as

this Commission pointed out in its report (sheet 56), with respect to the status of these bonds, "final adjudication of this and similar questions must be made by the Court," this Commission has nevertheless determined the question adversely to the R.C.C. and treated those bonds as being virtually worthless. Admittedly a legal question, it would seem that it should have been referred to the court for determination and alternative treatments proposed subject to subsequent judicial determination. The limited record before the Commission establishes some value in those bonds. The I.C.C. Plan also treats as worthless the claim of the Western Pacific Railroad Corporation, which the R.C.C. holds in pledge. If the capitalization were not so restricted it would be possible to provide for this claim as well as for the secured note holders. Capitalization in a reorganization should be *fair*; there is no warrant for making it either conservative or excessive. If it is less than *fair*, it diverts assets of the Debtor from creditors who are entitled to them. This is the sort of thing condemned by the Supreme Court. [650]

The I.C.C. Plan should provide for adequate capitalization to permit participation by all parties entitled to share in the capital assets of the Debtor; and in the distribution of said capital assets through the allocation of new securities ("share in the consideration to be distributed in reorganization"; "and equitable share in the debtor's assets": *Kuehner v. Irving Trust Co.*, 299 U. S. 445, 1937) due recognition be given (or suitable provision be made

for such recognition contingent upon subsequent judicial determination of the issues) to the prior lien of the General and Refunding Mortgage, to the extent that such lien exists, and that recognition be given to other items of collateral pledged by the Debtor.

3. Paragraph I (2) directs the establishment of a capital fund amounting to \$1,000,000, by annual instalments of not to exceed \$500,000.

However desirable generally, a capital fund in this instance is unnecessary and deprives junior creditors of earnings to which they are entitled. It is not clear that it is even desirable in the case of this debtor: since the proposal for a capital fund was first made, ten millions have been spent improving the property of the Debtor: no such fund, sterilizing a substantial part of the assets of the Debtor, should now be required.

Other persuasive arguments against such a fund are stated or referred to in the separate opinions herein of Mr. Commissioner Eastman (concurring in by Mr. Commissioner Aitchison), and of Mr. Commissioner Miller.

The I.C.C. Plan should restrict the capital fund to \$500,000, with instalments of not exceeding \$250,000, or eliminate it entirely.

4. Paragraph J (3) provides for the treatment of the secured notes of the R.C.C., R.F.C., and A. C. James Company.

For principal and interest (computed only to July 1, 1938), these [651] creditors are offered.

159,462 shares of no-par common stock (out of a total authorized issue of 500,000 shares, with 313,703 shares being issued at date of reorganization) divided between them on the basis of their respective holdings of the Debtor's General and Refunding bonds. No account is taken of other collateral. The value of this stock, as it is set up in the I.C.C. Plan, is best indicated by noting that although the Commission computes future earnings at about \$500,000 per annum, it has nevertheless set up charges ahead of dividends on the common stock such that it will be necessary to have earnings available for interest and dividends, in the sum of \$4,318,035 before even 3% can be paid on the common stock. This is a wholly unwarranted diversion of income (comparable to the diversion of capital assets, above discussed) from the General and Refunding Mortgage bonds to the First Mortgage bonds. Here again it would seem that if a proper allocation cannot be made without a judicial determination of the relative priorities, either the question should be referred to the Court and allocation held up until a decision is rendered, or the allocation should be so made that it can be adjusted to such ultimate judicial determination. The parties did not make a full presentation of their case upon this issue in the hearings before this Commission because it could not be settled here. It is unfair for the Commission to pre-judge the issue upon an incomplete record, and to act upon its *protem* finding as though it were final.

The additional offer of "warrants" to purchase new first mortgage bonds adds nothing. This provision, more fully treated in subsection 6 (*infra*), appears to be made to avoid possible technical objections.

The I.C.C. Plan should contain an alternative provision based on the assumed establishment of a prior lien as claimed by the Trustee of the General and Refunding Mortgage, or leave the matter open until after determination of the respective liens by the Court; and it should also give due recognition to other collateral pledged by the Debtor. A more equitable division of income [652] should be evolved.

5. Paragraph J (4) dismisses the claims of the Western Pacific Railroad Corporation as being without value.

The lack of value is due to the unwarranted diversion of capital assets and income, as above stated.

The I.C.C. Plan, modified as hereinabove proposed, in subparagraph 2, would necessarily make adequate provision for these claims.

6. Paragraph K deals with warrants to purchase new first mortgage bonds at their face value.

That it was not seriously contemplated that these warrants would be exercised by the R.C.C., R.F.C. and A. C. James Company is apparent from the fact that subsequent provision is made for the possible exercise of such warrants by the present first mortgage bondholders in case the first three creditors do not act, and failing in that, for a loan from the R.F.C. secured by new first mortgage bonds.

The marketability of the new first mortgage bonds is hardly enhanced by the provisions for using them as collateral in the event that no one is willing to buy them.

The warrants will have no value unless the terms upon which the bonds are to be issued are such as to make them worth more than their face amount, within the period of 45 days after date of reorganization. It is apparent from the certificate of incorporation of the R.C.C. that the R.C.C. could not exercise the warrants allocated to it. Whether or not it could sell such warrants within 45 days of the actual effective date of the plan, which, if it does occur, will be at an indefinite date in the future, is at this time a matter of pure speculation. It may truly be said of the warrants that they are thus made tokens for speculation in reorganization. If the new first mortgage bonds will be worth [653] more than their face amount at date of reorganization, a creditor's right of participation in the "profit" should not be dependent upon its corporate power to exercise warrants for purchase, or upon its ability to sell such warrants in a 45 day period. It would be unfair and inequitable to compel a creditor, especially a creditor dealing with trust funds, to embark upon such a speculation, even to the extent of assenting to a plan that involved its acceptance of such warrants, unless its claim against the Debtor were otherwise fully provided for. Neither is it fair or equitable to offer to creditors

terms which may be accepted by some but cannot be accepted by others.

This does not seem to be either a sound basis or method for the issue of new securities, however good they may be; neither does it seem to be a fair method, from the standpoint of other creditors.

The proposal for the issue of such warrants should be eliminated from the I.C.C. Plan, and other provision made for the creditors affected thereby.

7. Paragraph N provides, first, for the release and cancellation of existing mortgages, and for the surrender to the reorganized company of "all funds on deposit with the debtor's mortgage trustees," and of "all collateral pledged under the mortgage," free from existing liens; also of all collateral pledged by the debtor with the R.C.C., R.F.C. and A. C. James Company. (A further provision respecting the R.C.C. will be discussed below.)

It is clear that "the right to retain a lien until the debt secured thereby is paid is a substantive property right which may not be taken from the creditor consistently with the Fifth and Fourteenth Amendments to the Constitution" (*Security-First National Bank v. Rindge Land & Navigation Company*, 85 F. (2d) 557, C.C.A. 9, 1936). There can be no obligation upon the trustee under the General and Refunding Mortgage to surrender cash, deposited securities and other collateral, or to release the lien of that mortgage, until the bonds [654] thereunder have been satisfied, to the extent at least.

that the mortgage assets will permit. Similarly there can be no duty upon the R.C.C. to release its pledge unless and until pledge assets have been devoted to the satisfaction of its claim.

The L.C.C. Plan should be limited in accordance with the foregoing.

Paragraph N then proceeds to require the R.C.C. to release and surrender to the new company, the distributive shares of the Debtor under the Marshalling and Distributing Plan, 1931, "from and after the effective date of the plan," that is to say, the arbitrary date of July 1, 1938, and further provides that "any proceeds from such shares applied by The Railroad Credit Corporation to the payment of principal and/or interest of and upon the obligations of the debtor after the effective date of the plan, unless such application shall have been made by authority of the Court of competent jurisdiction, shall be turned over to the reorganized company."

In the absence of a voluntary acquiescence by the R.C.C., which has not been given, these provisions are completely unwarranted and cannot be supported in Court. The rights of the R.C.C. do not rest upon a court order and the R.C.C. cannot be required to seek a court order as a condition precedent to the exercise of its rights.

It may be noted in this connection that the claim of the R.C.C., as classified by the reorganization court, constitutes an entire class of claims. Where the statutory majority of an affected class dissent from a plan, the court may confirm the plan only

if it finds, *inter alia*, that the plan provides fair and equitable treatment for the rights and interests of those rejecting it and that their rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts. [655].

Not only is the R.C.C. entitled as pledgee to receive and apply the distributive shares of the Debtor, but under the terms of the Marshalling and Distributing Plan, 1931, to which both the R.C.C. and the Debtor are parties, the R.C.C. has the right and is in duty bound not to pay distributive shares in cash to participating carriers that have borrowed from and are indebted to the R.C.C., but instead to credit such shares upon such indebtedness. In view of the origin and purpose of the R.C.C., and the benefits derived from it by the Debtor and the First Mortgage bondholders of the Debtor, it would be most unfair and inequitable, even if it were lawful, as it is not, to require the R.C.C. to subject its rights to the provisions of Paragraph N.

Unless the arbitrary effective date is eliminated, as hereinabove proposed in subsection 1, the L.C.C. Plan should be modified by inserting therein the following provision which is contained in the order of this Commission (by Division 4) in Chicago Great Western Railroad Company Reorganization, F.D. No. 10772, decided August 4, 1938: "Nothing in the foregoing and other provisions herein with respect to The Railroad Credit Corporation is intended to

limit or in any manner affect the right of that Corporation to apply, in its discretion, the income on and proceeds of the collateral held by it, to or towards the payment of the principal, or interest, or both, of or upon its claim against the Debtor prior to the consummation of the reorganization."

8. Paragraph O declares that the approval and confirmation of the plan shall in no wise disturb or alter the right and interest of the R.F.C. and the R.C.C. in collateral pledged with them by parties other than the debtor.

Obviously the R.C.C. will not accept out of hand a plan which does not adequately provide for its claim, especially when acceptance would cut off the security of collateral pledged with it by third parties. Whether such security [656] is cut off or not is dependent upon established principles of law which cannot be altered by any provision in an order of this Commission.

The I.C.C. Plan treats the \$4,000,000 principal amount of Debtor's General and Refunding Mortgage bonds held in pledge by the R.C.C. as though they were pledged with it by the Debtor: the record shows that \$2,000,000 principal amount of said bonds were pledged with the R.C.C. by the A. C. James Co. Obviously the R.C.C. cannot surrender said bonds without the consent of the A. C. James Co. Under the terms of Paragraph O, the R.C.C. would not be required to surrender them. Paragraph N would not apply though presumably it

was intended to. The R.C.C. has previously suggested a simple method of meeting this difficulty, viz., the proposal of plan equivalents for General and Refunding bonds. If all parties assent to the L.C.C. Plan these mechanical details, which affect substantive rights, can be readily worked out; otherwise they will prove stumbling blocks.

The I.C.C. Plan should recognize and make provision for this situation by the method herein proposed.

### B

That as a result of extensive negotiations between the representatives of the Debtor, the First Mortgage Institutional Bondholders Committee, Reconstruction Finance Corporation, A. C. James Company, and The Railroad Credit Corporation, on November 30, 1938, a compromise plan of reorganization for the Debtor was tentatively agreed upon by all the conferees except one, who indicated that while his client might not assent to said plan, it might not oppose it. A copy of said compromise plan in outline is attached hereto, marked Exhibit A. Although said compromise plan does not give effect to the legal rights of The Railroad Credit Corporation and does give preferential treatment to the First Mortgage bondholders and the R.F.C., in the opinion of your Petitioner, [657] nevertheless The Railroad Credit Corporation tentatively assented to said plan as a compromise, in the hope and expectation that a speedy termination of the Western

Pacific Railroad Company reorganization might thus be brought about, avoiding further delay, litigation, and expense. Said compromise plan now appears to have been abandoned, at least for the present. A compromise plan will avoid the many complexities that have arisen in this proceeding, but such a plan, to become effective, must be accepted by all parties in interest. It will be noted that the capitalization after reorganization under the compromise plan will be \$94,647,981, if the non-par-common stock is set up on the basis of issue.

Your Petitioner believes that said compromise plan would still be acceptable, as a compromise, to all the parties that tentatively assented thereto, and that further negotiation, or minor modification by this Commission, would result in acceptance thereof by all parties in interest.

Wherefore, The Railroad Credit Corporation prays that the Order of the Commission herein, dated October 10, 1938, and the Report accompanying said Order, be modified in the several respects hereinabove set forth in paragraph A, and in such other respects as may be necessary to give effect thereto; and as may be approved by this Commission; or, alternatively, and preferably, that said Order and Report be so modified as to give effect to the aforesaid compromise plan hereinabove referred to in paragraph B, and attached hereto as Exhibit A, with such amplification and such further

modification thereof, if any, as may be agreed to by the parties in interest, and approved by this Commission.

Respectfully submitted,

**THE RAILROAD CREDIT  
CORPORATION,**

Intervening Petitioner.

By D. WILLARD, JR.

Vice President and General Counsel.

Washington, D. C.,

December 9, 1938. [658]

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon all parties of record in this proceeding, by mailing a copy thereof properly addressed to each party.

Dated at Washington, D. C., this 9th day of December, 1938.

D. WILLARD, JR.,

Vice President and General Counsel,

The Railroad Credit Corporation.

Office and P. O. Address:

228 Transportation Building,

17th and H Streets, N. W.,

Washington, D. C. [659]



# EXHIBIT A TO PETITION OF THE RAILROAD CREDIT CORP.

## PROPOSED CAPITALIZATION

Effective Date January 1, 1939

Title of Issue	Presently Issued	Interest or Dividends
Undisturbed Equipment Trusts, Baldwin Lease and Pullman Contract	\$ 2,750,050	\$ 94,202
First Mortgage 4% Bonds, Series A, due 1989	10,000,000	400,000
Total Annual Fixed Charges		494,202
Capital Fund		200,000
Income Mortgage 4% Bonds, Series A, due 2014	20,901,240	836,050
Total Funded Debt	33,651,290	
Total Annual Charges (fixed and contingent) and Capital Fund		1,630,252
Income Mortgage Sinking Fund		104,506
Participating 5% Preferred Stock (par value \$100)	33,797,670	1,689,835
Participating 4% Preferred Stock (par value \$100)	14,190,318	567,613
Total Annual Charges, Capital Fund, Sinking Fund and Preferred Dividend Requirements		3,992,206
Common Stock (without par value)	343,736 shs.	
Capitalization (Common at \$100 per share)	\$115,850,714	
Preferred Stock Begins Participating After		5,023,397

## TREATMENT OF EXISTING SECURITIES

### 1. In Respect of each \$1,000 of Principal

	Income Mortgage Bonds	5% Preferred Stock	Common Stock	Rate Per Share of Common
First Mortgage Bonds	400	600		
R. F. C.	400	600		
R. C. C.	—	1000		
A. C. J.	—	—	30 shs.	\$33.33
W. P. RR. Corp.	—	—	20 shs.	\$50.00

### 2. In Respect of each \$100 of Interest

	Income Mortgage Bonds	4% Preferred Stock	Common Stock	Rate Per Share of Common
First Mortgage Bonds	—	\$100		
R. F. C.	—	100		
R. C. C.	—	100		
A. C. J.	—	—	3 shs.	\$33.33
W. P. RR. Corp.	—	—	2 shs.	\$50.00

Total Funded Debt	33,651,290	
Total Annual Charges (fixed and contingent) and Capital Fund		1,630,252
Income Mortgage Sinking Fund		104,506
Participating 5% Preferred Stock (par value \$100)	33,797,670	1,689,835
Participating 4% Preferred Stock (par value \$100)	14,190,318	567,613
Total Annual Charges, Capital Fund, Sinking Fund and Preferred Dividend Requirements		3,992,206
Common Stock (without par value)	343,730 shs.	
Capitalization (Common at \$100 per share)	\$115,850,711	
Preferred Stock Begins Participating After		5,023,397

### TREATMENT OF EXISTING SECURITIES

#### 1. In Respect of each \$1,000 of Principal

	Income Mortgage Bonds	5% Preferred Stock	Common Stock	Rate Per Share of Common
First Mortgage Bonds	400	600		
R. F. C.	400	600		
R. C. C.	—	1000		
A. C. J.	—	—	30 shs.	\$33.33
W. P. RR. Corp.	—	—	20 shs.	\$50.00

#### 2. In Respect of each \$100 of Interest

	Income Mortgage Bonds	4% Preferred Stock	Common Stock	Rate Per Share of Common
First Mortgage Bonds	—	\$100		
R. F. C.	—	100		
R. C. C.	—	100		
A. C. J.	—	—	3 shs.	\$33.33
W. P. RR. Corp.	—	—	2 shs.	\$50.00

#### 3. Distribution of Stock

	5% Preferred	4% Preferred	Common
First Mortgage Bonds	\$29,574,060	\$13,143,945	
R. F. C.	1,778,000	899,870	
R. C. C.	2,445,610	146,503	
A. C. J.			187,536
W. P. RR. Corp.			156,194
Total	\$33,797,670	\$14,190,318	343,730

[Endorsed]: Filed Oct. 5, 1939. [660]



Before the Interstate Commerce Commission  
Finanee Docket No. 10913

In the Matter of

**THE WESTERN PACIFIC RAILROAD  
COMPANY REORGANIZATION**

**PETITION FOR MODIFICATION OF THE  
COMMISSION'S REPORT AND ORDER  
OF OCTOBER 10, 1938, ON BEHALF OF  
RECONSTRUCTION FINANCE CORPO-  
RATION [661]**

**Petition for Modification**

Comes now Reconstruction Finance Corporation (hereinafter called Reconstruction), an intervener in the above-entitled proceeding, and respectfully petitions the Interstate Commerce Commission (hereinafter called the Commission) to modify its Report and Order herein, of October 10, 1938, and in support of said petition respectfully shows:

**I.**

Contemporaneously herewith the Committee (hereinafter called the Committee) representing certain institutional holders of First Mortgage Bonds of The Western Pacific Railroad Company (hereinafter called the Debtor), acting under a group agreement dated as of September 1, 1936, and consisting of Frederick H. Ecker, Chairman, John W. Stedman, and Reeve Schley, are petitioning the Commission for a modification of said Report and Order. The modifications proposed by the Committee

are set forth in the [662] Committee's Modified Plan, which it is annexing to its petition.

## II.

The provisions affecting Reconstruction in said modified plan meet with the approval of Reconstruction.

## III.

Reconstruction has the following objection, among others, to the plan approved by the Commission in its report and order herein dated October 10, 1938:

Pursuant to the approval of the Commission granted in its report and certificate of November 10, 1938, in Finance Docket No. 12213, Reconstruction, as of December 1, 1938, loaned to the Debtor's Trustees the sum of \$9,902,921.95, taking in evidence of such loan, by way of discount from face value such as to make the yield on the Trustee's Certificates next hereinafter mentioned from the date thereof to the date of maturity 4 per cent. Certificates of the Debtor's Trustees in the aggregate principal amount of \$10,000,000, dated December 1, 1938, maturing December 1, 1939, and bearing interest by their terms at the rate of 3 per cent per annum, payable semi-annually. [663]

As appears from the foregoing, the \$10,000,000 of Trustees' Certificates have been acquired by Reconstruction since the date of the Commission's report and order herein of October

19, 1938, approving a plan. The Commission's approval of the acquisition by Reconstruction of said \$10,000,000 of Trustees' Certificates was also granted, on November 10, 1938, in Finance Docket No. 12213, subsequent to the Commission's report and order herein of October 10, 1938, approving a plan.

As required by the terms of the Commission's report and certificate in Finance Docket No. 12213, said \$10,000,000 of Trustees' Certificates "rank as expenses of the administration by the court of the property of the Western Pacific" and as such "constitute, equally with other expenses of administration, a direct charge and lien on all property held by the applicants as such Trustees".

These Certificates, therefore, are secured by a lien prior to any of the Debtor's mortgages.

They constitute an obligation of the Trustees and "expenses of administration".

Under the Commission's plan (page 2 of order of October 10, 1938), \$10,000,000 of new First Mortgage Bonds [664] are to be sold to provide the money to pay off these Trustees' Certificates or are to be pledged "with such additional amount of such bonds as may be necessary to be pledged under a \$10,000,000 short-term note" as security for a loan of \$10,000,000 to be obtained for the same purpose. The new First Mortgage Bonds in question are

to bear interest at the rate of 4 per cent but the Commission's plan provides "that interest accruing for a period not exceeding five years from the effective date of the reorganization, or any portion thereof, on such bonds shall accumulate and payment thereof shall be made only at such times as earnings are available therefor". In other words, the interest on such bonds, although cumulative if unpaid, is not to become a fixed charge until five years from the effective date of the reorganization.

In the opinion of Reconstruction the provisions of the Commission's plan above referred to do not constitute a feasible method of refinancing the \$10,000,000 of Trustees' Certificates which Reconstruction now holds.

Reconstruction respectfully submits that any approved reorganization plan should provide a feasible method of refinancing the \$10,000,000 of Trustees' Certificates which [665] Reconstruction now holds. The Commission's plan proposes (pages 1 and 2 of the order) that the new First Mortgage Bonds provided for therein shall have a maturity of fifty years and be part of an authorized issue of bonds limited to \$50,000,000. If Reconstruction should take, either in evidence of a loan or as collateral for a loan made to pay off said \$10,000,000 of Trustees' Certificates which it now holds, the new First Mortgage Bonds provided for in the Commission's plan, Reconstruction's present security would be subject to dilution and impairment.

Paragraphs (d) and (e) of Section 77 of the Bankruptcy Act apparently require the liquidation in cash of Trustees' obligations. A reading of those paragraphs clearly indicates that the term "creditors" as used throughout refers to creditors of the debtor and not to creditors of the debtor's trustees. This is made even clearer by a provision in paragraph (e) to the effect that the court shall approve the plan (previously approved by the Commission) if satisfied, among other things, that "the plan provides for the payment of all costs of administration". This certainly includes Trustees' Certificates of indebtedness authorized by the court, and in the instant case, the Certificates by their [666] terms are "expenses of administration" by the court.

In setting forth the above objection to the Commission's plan, Reconstruction is not to be deemed as waiving other objections thereto which it may wish to urge, upon a rehearing herein before the Commission, or in the Court.

#### IV.

It is respectfully submitted that the modifications of the Commission's plan suggested by the Committee offer Reconstruction better treatment of its claim of \$2,963,000 (on which there will be interest accrued and unpaid as of January 1, 1938, amounting to \$899,870), representing loans made by Reconstruction pursuant to the prior approval of the

Commission granted in the Commission's reports and certificates of February 24, 1932 in Finance Docket No. 9151, and of June 23, 1932 and February 25, 1933 in Finance Docket No. 9448, than does the Commission's plan. Under the modifications proposed by the Committee Reconstruction will receive the following:

\$1,185,200 income mortgage 4½% bonds (being 40% of the principal of its claim);

\$1,777,000 5% preferred stock, Series A (being 60% of the principal of its claim); and

[667]

13,498 shares of common stock (being common stock at the price of 66-⅔ per share or 100% of its accrued and unpaid interest).

Under the Commission's plan Reconstruction will receive 90,255½ shares of common stock:

## V.

In consideration of the effectuation of a plan providing for the treatment of said claim as proposed in the Committee's modifications, Reconstruction is willing, subject to the approval of the Commission, not to insist on its rights under Section 77 of the Bankruptcy Act that the \$10,000,000 of Trustees' Certificates which it holds be paid in cash, but instead, subject likewise to the Commission's approval, to take in exchange for said \$10,000,000 of Trustees' Certificates, \$10,000,000 of new First Mortgage Bonds bearing fixed interest at the rate

of 4 per cent per annum, maturing in 25 years and having the other terms, provisions and conditions set forth in the Committee's modified plan. Reconstruction respectfully submits that, as a matter of fairness and equity, it is entitled to at least as good treatment, in respect of its claim of \$2,963,000 and accrued interest, as is offered in the Committee's modified plan, if it takes, for the \$10,000,000 of Trustee's Certificates which it holds, new securities instead of cash. [668]

Wherefore, Reconstruction prays that the Commission's Report and Order herein, of October 10, 1938, be modified by the approval of the Committee's modified plan; and that if such modified plan be not approved, the Commission's plan, nevertheless, be modified, to make adequate provision to meet the objection thereto set forth above and such other objections thereto as Reconstruction may urge, at a rehearing which, in such event, the Commission is asked to grant in these proceedings; and that the Commission enter such further order or orders in the premises as to it may seem just and reasonable.

Dated: Washington, D. C., December 9, 1938.

RECONSTRUCTION FINANCE

CORPORATION,

By C. M. CLAY

Assistant General Counsel.

Of Counsel:

CLAUDE S. HAMILTON, JR.,

General Counsel.

[Endorsed]: Filed Oct. 5, 1939. [669]

Before The  
Interstate Commerce Commission

Finance Docket No. 10913

In the Matter of  
The Western Pacific Railroad Company Reor-  
ganization

PETITION OF THE WESTERN PACIFIC  
RAILROAD COMPANY UNDER SUBSEC-  
TION (d) OF SECTION 77 OF THE BANK-  
RUPTCY ACT FOR A MODIFICATION OF  
REPORT AND ORDER OF THE COMMIS-  
SION AND FOR A FURTHER HEARING

This Petition of The Western Pacific Railroad Company, herein sometimes called the Debtor, respectfully shows to the Interstate Commerce Commission:

First: That the Plan of Reorganization of The Western Pacific Railroad Company approved by the Interstate Commerce Commission in its Report and Order dated October 10, 1938, is unjust, inequitable, fails to afford due recognition to the rights of stockholders, discriminates unfairly in favor of certain creditors and fails to conform to the requirements of the law of the land re- [671] garding the participation of the various classes of creditors and stockholders in the particulars hereinafter specified, among others not specified in the interest of brevity.

Second: The basic injustice (we use the language of the Statute without implication of disrespect to the

Commission) lies in the proposal of the Commission (we believe without statutory authority) to limit the capitalization of the reorganized Company to \$93,726,517, including 313,703 shares of no par value stock valued for purposes of the Plan (we believe unnecessarily and arbitrarily) at \$100 per share, thereby *transferring* to senior interests (who do not seek such transfer) all equity in the property which measured by the constitutional right of presently invested capital to earn a fair return exceeds \$45,863,938—the excess being the difference between the Commission's valuation under 19a stated as of December 31, 1935, at \$139,600,455, and that part of the proceeds of sale of \$10,000,000 principal amount of Trustees' Certificates expended for capital improvements, the greater part of which expenditures were made subsequent to that date.

Third: In the preparation of its case for presentation to the Commission the Debtor estimated earnings available for interest of the property for the years 1936-1940, as follows:

1936	\$1,521,386
1937	2,180,586
1938	2,738,886
1939	3,365,836
1940	3,769,836

[672]

That these were estimates of minimum prospective earning power and were designed to show (and were offered for no other purpose) that an annual

fixed charge of \$1,027,036 was ultra conservative. That the properties of the Debtor have been placed in condition for exceptionally economical and efficient operation at a cost of \$10,000,000, thereby substantially completing an earlier program of \$18,000,000; that new and highly promising channels of trade have been opened up (including the Northern California Extension and the Dotsero Cut-Off) which have vastly improved the potential earning power of the property and rendered obsolete earnings studies and estimates based upon predepression traffic. That if the Commission asserts the power under Section 77 of limiting capitalization on the basis of its own estimate of prospective earnings (a power we earnestly insist the Commission does not have and may not exercise) then in equity and good conscience it should permit the case to be reopened to receive evidence as to probable maximum earning power and not treat as a ceiling the conservative estimate of minimum earning power offered by the Debtor on the totally different issue of a safe fixed charge.

Fourth: A strikingly inequitable feature of the Plan approved by the Commission (unjustifiable under any accepted legal principle) is in the use of no par value stock of the reorganized Company as an elastic currency for adjusting creditor claims—\$77.25 in paying the accumulated interest on First Mortgage Bonds, \$40.00 in paying the principal and interest of the claim of Reconstruction Finance Corporation, \$76.70 in paying the principal and

interest of the claim of The Railroad Credit Corporation, [673] and \$172.25 in discharging the claim of A. C. James Company. Much has been said by pseudo economists in favor of an elastic currency, but none has yet ventured to suggest that the same currency be given four different values in settling four different debts at the same time and place.

Fifth: The Plan fails to give any recognition to the rights of the Debtor's unsecured creditors and stockholders, although the valuation placed by the Commission upon the Common Stock of the reorganized Company in fixing capitalization at \$93,726,517 demonstrates mathematically the existence of a substantial equity even upon a valuation of only \$93,726,517—a valuation which we are confident would be held confiscatory by the Court.

Sixth: That under the Plan approved by the Commission, provision is made (a) for an annual capital fund of \$500,000 and a sinking fund of \$197,160, a total of \$697,160. This amount capitalized at 4% would provide an additional capitalization of \$17,429,000, which belongs and should be credited to the equity and which if represented by new Common Stock (valued at \$100. a share) alone provides sufficient additional Common Stock to discharge \$7,809,639 of non-negotiable debt to The Western Pacific Railroad Corporation and Western Realty Company and permits an allotment of nearly \$10,000,000. of new stock to the present stockholding interests of the Debtor. This adjustment may be made

without departure from the principles underlying the Commission's Report and Order.

Seventh: That unless the Commission will modify the proposed Plan so as to give substantial recognition to the true value of the rehabilitated Western Pacific [674] railroad the inevitable alternative is long litigation which ought to be avoided in the interest of the railroad industry and those unfortunate creditors and stockholders who believed that capital invested in the property would be given a square deal. That various modifications of the Commission's Plan have been discussed by counsel representing all creditor interests (except the very large amount of First Mortgage Bonds not represented by the Stedman-Schley-Haggerty Committee) and while no accord was reached in these discussions it is, nevertheless, the judgment of the Debtor that if the Commission or Division 4 will meet all parties in a conference and will in such conference undertake to mediate and reconcile the differences between the parties, a Plan ought readily be evolved which would be acceptable to reasonable men and could be promptly carried into effect without litigation and without further discredit to Section 77 of the Bankruptcy Act.

Wherefore, the petitioning Debtor, The Western Pacific Railroad Company, respectfully prays for an order modifying the Plan so as to give due recognition to the rights of the Debtor's unsecured creditors and stockholders through the authorization of additional capital stock out of a total capitaliza-

tion of not less than \$120,000,000. or, in the alternative, reopening this proceeding for further testimony and argument.

Respectfully submitted,

FRANK C. NICODEMUS, JR.,

Counsel

The Western Pacific Railroad

Company

40 Wall Street

New York City [675]

State of New York,

County of New York,—ss.:

Michael J. Curry, being duly sworn, deposes and says: That he is Vice President of the above named petitioner, The Western Pacific Railroad Company; that he has read the foregoing petition and knows the contents thereof and verily believes it to be true in all respects.

MICHAEL J. CURRY.

Subscribed and sworn to before me this 8th day of December, 1938.

[Seal] (Signed) HOWARD A. FISCHER  
Notary Public, Kings, Co. No. 123, Reg. No. 230  
Cert. filed in N. Y. Co. No. 306, Reg. No. 0-F-187  
Commission expires March 30, 1940

[Endorsed]: Filed Oct. 5, 1939: [676]

Before the  
Interstate Commerce Commission

Finance Docket No. 10,913

In the Matter of

**WESTERN PACIFIC RAILROAD  
COMPANY REORGANIZATION**

**PETITION OF IRVING TRUST COMPANY,  
AS TRUSTEE UNDER GENERAL MORT-  
GAGE, FOR MODIFICATION OF COM-  
MISSION'S REPORT DATED OCTOBER  
10, 1938; AND BRIEF IN SUPPORT  
THEREOF [677]**

**PETITION OF IRVING TRUST COMPANY,  
AS TRUSTEE UNDER GENERAL MORT-  
GAGE, FOR MODIFICATION OF COM-  
MISSION'S REPORT DATED OCTOBER  
10, 1938**

The petition of Irving Trust Company respectfully shows, on information and belief:

Your petitioner is a New York corporation, and is Successor Trustee under the General and Refunding Mortgage of Western Pacific Railroad Company, dated January 1, 1932, under which there are outstanding \$18,999,500 principal amount of bonds.

This petition relates only to the failure of the plan proposed by the Commission to give any recognition to the valuable collateral held by the General Mortgage Trustee which is admittedly free

from the lien of the First Mortgage. By that plan, the First Mortgage bondholders receive income-mortgage bonds and preferred stock for the full amount of their bonds, plus common stock for their accrued interest, while the creditors secured by General Mortgage bonds receive only common stock, in proportion to their holdings of bonds. This petition is concerned with the primary [678] question of priority between creditors, rather than with such matters as total capitalization, and terms of new securities, on which the creditors themselves will make their position known.

We do not in this petition ask modification of the report concerning the priority of lien on the Northern California extension, on the debtor's equity in rolling stock subject to leases, conditional sales agreements, or equipment trust agreements, or on non-carrier real estate. Although we disagree with the Commission's ruling that such items are subject to the entire First Mortgage as a first lien, we consider that review of these questions may best be had in the Court, in view of the statement in the Report (Sheet 56) that the Commission's determination of these questions is purely preliminary, and that final adjudication must be made by the Court.

Substantial property remains subject to the General Mortgage as a first lien, however, even if the items just mentioned be eliminated. The existence of *any* property subject to the General Mortgage and not to the First Mortgage, would make it improper to allot only common stock to the holders of

General Mortgage bonds, and to require at the same time, as the Commission's plan does (Report, Sheets 69-70), that all collateral now pledged under the mortgages be surrendered to the reorganized company free from lien.

When the properties on which the General Mortgage is *admittedly* a first lien are as substantial in relation to the debt secured as are those described below, it is manifest error not to provide for giving to the holders of General Mortgage bonds a proportionate share of securities equal in lien to any allotted to First Mortgage bondholders. The General Mortgage Trustee considers [679] that the Commission, in failing to make such provision, committed an inadvertent error, which it will itself desire to correct.

The Commission rightly states in its Report (Sheet 59) that (with certain exceptions here immaterial):

*"there is no contention that the cash and collateral held by the trustee under the general and refunding mortgage are not free from the lien of the first mortgage"*.

The Commission further recognized (Sheet 59) that "due recognition must be accorded to the rights of the creditors with whom are pledged general-mortgage bonds".

It is submitted that the Commission failed to give such "due recognition" to the holders of General Mortgage bonds, and that it overlooked the impor-

tance in relation to the amount of General Mortgage bonds and the debts secured thereby of the collateral on which the General Mortgage is a first lien; otherwise it could not have stated as it did (Sheet 60) that the First Mortgage bondholders should be considered as having a first lien "upon practically all the assets of the debtor" and should—without any qualification or exception—"receive securities of a higher rank than those allocated to other creditors".

The value of collateral admittedly free from the lien of the First Mortgage is substantial in relation to the debt secured by General Mortgage bonds.

The total principal amount of debts secured by General Mortgage bonds is approximately \$10,500,000 (Exhibit 9). [680]

Collateral to the General Mortgage undisputedly free from the First Mortgage amounts at the very least to over \$3,000,000—even after eliminating, among other things, the Northern California extension, equipment and non-carrier real estate, on which the Commission has given a preliminary decision contrary to the General Mortgage contentions, and the Deep Creek and Standard Realty & Development notes, on which the lien of the General Mortgage is disputed. With the inclusion of cash which is free from any mortgage the total which must be considered in determining what constitutes due recognition for the General Mortgage bondholders is over \$4,000,000. This amount is made up as follows:

Cash in hands of General Mortgage Trustee (including all sums received to date)	\$ 223,732
Note of Tidewater Southern Railway Company (Exhibit 126)	508,278
Stock of Tidewater Southern Railway Company, at I. C. C. valuation of assets (Exhibit 103; 82, p. 16; and 29, Statement No. 16, p. 4)	1,567,109
Central California Traction Company securities at book value to Western Pacific (Exhibit 103; and 82, p. 16)	
Bonds	\$270,000
Preferred stock	264,715
Common stock	128,651
Alameda Belt Line stock at book value to Western Pacific (Exhibit 103)	465,300
Total	3,427,785
To this may also be added the cash on hand at the institution of the reorganization proceedings, free from both mortgages (Rec. p. 586, adjusted to eliminate Tidewater Southern interest payments subsequently turned over to General Mortgage Trustee), amounting to	810,331
Total, including free cash	\$4,238,116
	[681]

Nor do the above totals include (1) various important pieces of real estate listed in the item of miscellaneous physical property at page 9 of our brief dated January 11, 1937 which were acquired subsequent to the 1915 reorganization, and are not governed by the same reasoning (assuming, which we do not admit, that the reasoning is valid) used by the Commission at Sheet 59 of its Report in holding the First Mortgage a lien upon non-carrier real estate owned before 1915; (2) industrial tracks

and spurs in respect of which no First-Mortgage money was expended; (3) miscellaneous other property acquired from free funds (Rec. pp. 585, 690); nor (4) the twenty-three miles of branches or jointly owned tracks listed at pages 56 to 57 of our January 11, 1937 brief in respect of which no First Mortgage money was used. The figures above may therefore be regarded as stating the General Mortgage rights quite conservatively.

The amounts listed above are real values, and not mere book figures. The value of the cash is clear beyond question. And no one can say of any of the three roads whose securities are listed above (Tidewater Southern, Central California Traction and Alameda Belt Line) that economically its original construction was an ill-advised undertaking. (Cf. Report, Sheet 41.)

The Tidewater Southern is an important feeder to the Western Pacific (Rec. p. 109; Ex. 82, p. 16); described by Mr. Swaine as one of its "important" subsidiaries (Rec. p. 136). It contributes freight yielding a steady revenue averaging over \$500,000 per year to Western Pacific (Exhibit 82, pp. 16-17; and Exhibit 27, Statement No. 4, p. 2). Its note, which regularly earns and pays the specified 5% interest, is surely worth face value. [682] The valuation of its stock is not based primarily upon book value, but is rested on this Commission's valuation of the property. This valuation is confirmed by the earnings record of the Company (Ex. 29, Statement No. 28). Its conservative character is

shown by the fact that the value shown by the Tidewater Southern books is nearly 50% higher than the figure listed above (Exhibit 82, p. 16).

The Central California Traction Company is likewise a line of strategic importance, in which Western Pacific could not well afford to lose its one-third share. As stated in Western Pacific's application to the R. F. C., it "has a special value to the applicant as a feeder and would be of value to any corporation which might succeed to the properties of the applicant" (Exhibit 82, p. 17; Rec. p. 165). It serves a rich fruit-producing area, originating much interstate and transcontinental traffic (Ex. 195, p. 32). It contributed freight yielding a revenue during the depression years of over \$200,000 per year to the Western Pacific System (Rec. p. 165). The Central California Traction bonds continue to pay the stipulated 5% interest, the Reorganization Trustees considering it important not to permit any default thereon. If these bonds and stock, constituting part of the General Mortgage collateral, were liquidated on foreclosure by sale to Atchison and Southern Pacific, which own the other two-thirds of the line, the consequent loss of freight revenues to Western Pacific might be even more serious than the valuation given above indicates.

Alameda Belt Line is both a feeder and terminal line, owned jointly with The Atchison, Topeka & Santa Fe Railway, serving important docks and industries in Alameda (Ex. 29, Statement No. 33). Its ownership [683] is important to maintain the

debtor's equality with the Atchison in access to and traffic from Alameda.

It is fair to consider also the cash on hand at the time the proceedings were instituted as having a bearing on the rights of the General Mortgage bondholders. Although such cash is not subject to any mortgage (*Pintsch Compressing Co. v. Buffalo Gas Co.*, 280 Fed. 830, 838—C.C.A. 2nd), it is by the same token available for creditors who are not secured; and to the extent that the First Mortgage is held by the Commission to be protected by a prior lien on the debtor's property and the General Mortgage is relegated to a subordinate position, this cash should in any equitable distribution of property be availed of to satisfy the general creditor or deficiency-judgment claim of the General Mortgage bondholders. The First Mortgage bondholders have no such general creditor position, since the Commission has found that the value of the property on which their mortgage is a lien is as great as the amount of their bonds.

The only argument made by the First Mortgage trustees (Brief dated January 9, 1937, p. 68) for not giving consideration to this free cash was that it had been used *subsequent* to the institution of these proceedings for maintenance and rehabilitation of the road. However, such application of funds against which the General Mortgage bondholders had a right prior to that of the First Mortgage bondholders cannot change the situation as it existed at the date of instituting the reorganization.

proceedings, nor compel the Commission to disregard such cash in determining the rights of the General Mortgage bondholders. [684]

The earnings of the collateral admittedly subject to the General Mortgage are substantial in relation to the debt secured thereby.

The value of the securities on which the General Mortgage is admitted to be the first lien is supported also by their earnings.

Tidewater Southern in addition to paying 5% interest on its note, or approximately \$25,400 per year, earns a substantial net income (Exhibit 29, Statement No. 28). Such income averaged approximately \$47,000 from 1930 to 1935 inclusive, and was over \$75,000 in the latter years. It has failed to meet interest charges in full in only three years between 1922 and 1935. (*Ibid.*) Its estimated income from 1936 to 1940, after note interest, averages over \$75,000 per year (Ex. 29, Statements Nos. 3-7), which we believe will be borne out by the facts, since the estimates in the case of this road are based only upon existing traffic, and not upon any anticipated increases therein (Ex. 29, Statements Nos. 3 to 7). Some further indication of the earning power of Tidewater Southern is shown by the fact that it extinguished, in 1935, its entire bonded debt\* (Ex. 29, Statement No. 1, Note 8), repaying to Western

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\*The note, its only remaining obligation, represents expenditures for additions and betterments to the line (Rec. p. 217).

Pacific a total of \$129,921 during the years 1934 and 1935, and being left with cash on hand, on December 31, 1935, amounting to \$153,192 (Ex. 29, Statement No. 13), against total current liabilities of \$82,290 (Ex. 30). Income from Tidewater Southern represented more than 11% of the net income of the Western Pacific System as forecast for 1936 (Ex. 29, Statement No. 3). [685]

The Central California Traction bonds continue to pay their interest amounting to \$13,500 per year.

The above figures indicate minimum earnings for this portion of the General Mortgage collateral of approximately \$114,000 per year, without considering the amount which the other items of General Mortgage collateral (pp. 4-5, *supra*) contribute to the total Western Pacific earnings (as to which see, for instance, Exhibits 113, 115, 116). These latter items should contribute a considerable further sum.

In relation to the amount of General Mortgage debt, the earnings of the General Mortgage collateral are substantial, and may not be disregarded. No plan can be fair which requires the creditors secured by General Mortgage bonds to release their lien on collateral which earns such a substantial amount of money per annum, in exchange for nothing but common stock, which will produce no return unless system earnings return to the 1926 level (Report, Sheets 19, 55). [686]

Wherefore, it is respectfully requested that the Commission, pursuant to Section 77(d) of the Bankruptcy Act, modify its proposed plan of re-

organization so as to provide for the issuance to the General Mortgage bondholders of securities on a par with those awarded to First Mortgage bondholders, to the extent of the value of collateral on which the General Mortgage is admittedly a first lien.

Dated: New York, December 9, 1938.

IRVING TRUST COMPANY,

as Trustee,

By FREDERICK G. HERBST,

Vice President.

H. C. McCOLLOM,

ORRIN G. JUDD,

Attorneys for Trustee,

Office and Post Office Address,

One Wall Street,

Borough of Manhattan,

City of New York. [687]

State of New York,

County of New York:—ss.

Frederick G. Herbst, being duly sworn, deposes and says that he is a Vice President of Irving Trust Company, the petitioner in the above entitled proceeding; that he has read the foregoing petition and knows the contents thereof; that the same is true to his own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters he believes it to be true.

FREDERICK G. HERBST.

Sworn to before me this 9th day of December,  
1938. . .

GEO. R. HENRY

Notary Public, Kings County No. 431 Register's  
No. 9132

Cert. filed N. Y. Co. No. 299, Reg. No. 9H250.

Commission expires March 30, 1939. [688]

Before the  
Interstate Commerce Commission

Finance Docket No. 10,913

In the Matter of the  
Western Pacific Railroad Company Reorganization

BRIEF IN SUPPORT OF FOREGOING  
PETITION

The facts supporting the General Mortgage Trustee's limited request for modification of the Commission's report are fully set forth in the foregoing petition, and will not be repeated here. It is sufficient for the present purpose to set forth briefly the legal considerations which require that recognition be given to the substantial actual value, and earnings, of the property admittedly free from the lien of the First Mortgage, and that securities of a rank equal to those given the First Mortgage bondholders be accordingly awarded to the General Mortgage bondholders.

A plan is not fair and equitable which denies recognition to the admittedly prior lien of the General Mortgage upon substantial property.

The statute (Sec. 77(d)) commands the Commission, in approving a plan, to determine that the plan will [689] meet the requirements of sub-section (e) of Section 77. That sub-section states among other things that the plan must be one which "is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders" (Sec. 77(e)(1)).

The requirement of a release of the substantial collateral which is subject only to the General Mortgage, while giving the creditors secured by the General Mortgage bonds nothing but common stock, preceded by new first mortgage bonds, new income bonds and new preferred stock, does not afford due recognition to their rights, but on the contrary discriminates unfairly in favor of the First Mortgage creditors.

If the General Mortgage and First Mortgage were foreclosed, the creditors secured by the General Mortgage would inevitably obtain (1) the items listed above (excluding free cash), and would also be entitled to (2) the debtor's equity of redemption in the property subject to the First Mortgage and (3) a deficiency judgment for any excess due on

their bonds, thus giving them rights as general creditors against the free cash above mentioned, and any other unmortgaged assets. The common stock allotted to the General Mortgage bondholders represents merely the equity in the Western Pacific property over and above the amount of the present First Mortgage. In other words, it constitutes recognition of only one of the three rights above mentioned of the General Mortgage bondholders, namely, the equity of redemption in the property subject to the [690] First Mortgage. Nothing is given in exchange for the first lien on other property, or in exchange for the general creditor position against the free cash.

Citation is hardly necessary to bulwark the statutory requirement of due recognition to the rights of each class of creditors. The statement in the Radford case (Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 580) is nevertheless pertinent that the "right of the mortgagee to insist upon full payment before giving up his security has been deemed of the essence of a mortgage". This right cannot be taken away even under the bankruptcy power without some fair compensatory equivalent in recognition.

As was stated in *In re Chicago & N. W. Ry. Co.*, 18 F. Supp. 932, 936 (N. D. Ill.):

"Even a plan of reorganization should not be permitted to change the *relative* rights, interests and preferences of the persons interested in the estate of the debtor." (Italics ours.)

Principles similar to those on which we here rely were applied in an equity receivership case, in Guaranty Trust Co. v. Missouri Pacific Railway Co. (238 Fed. 812, E.D. Mo.). In a plan of reorganization of the Missouri Pacific railroad therein proposed, holders of so-called Series A bonds were found to be entitled to (1) a first lien upon property of a Missouri Pacific subsidiary, and (2) a general creditor position against Missouri Pacific as guarantor of the subsidiary's bonds. Under the plan, they were given a choice either on the one hand of retaining their mortgage security and losing their creditor rights, or on the other hand of abandoning their mortgage and being treated on a par [691] with general creditors of Missouri Pacific for the face amount of their bonds. The situation is similar to that in the present case, where the General Mortgage bondholders are required to give up their mortgage on properties where they have the first lien, and be treated only as second mortgagees. The court there held that the treatment proposed was unfair, and that the holders of Series A bonds should be entitled both to the benefit of their mortgage position, and also to their general creditor position for the deficiency, without being forced to surrender their mortgage position as a condition of recognition of their junior rights. The court stated (p. 819):

"\* \* \* the plan is so framed that, if they insist upon their mortgage security, they lose their rights as creditors under the contract. In

other words, the tender of preferred stock would not in that case be open to them for any part of their demands. On the other hand, if they accept the offer of preferred stock, they must abandon their mortgage. In that case they would get no more than a general creditor with no security whatever. These bondholders became creditors of the Missouri Pacific Company by virtue of its contract, irrespective of the Kansas City Northwestern mortgage, and, as such, their rights were equal to those of all general creditors, and ~~superior to those of the~~ stockholders. It does not seem equitable that, to maintain that parity and priority, they should be required to abandon their mortgage. Other general creditors, to whom preferred stock is offered, have nothing and give up nothing of security, but their proper relation to the old stockholders is fairly recognized.

The situation reduces itself to this: Whether those conducting the plan of reorganization decide [692] to include the Kansas City Northwestern Railroad in the new system or to exclude it, consideration should be given to the mortgage securing the series A bonds, and after the application of the value or proceeds of the mortgaged property determined by agreement or by foreclosure and sale the deficiency should have equitable recognition in the plan as a general debt."

To the same effect, see Note, 35 Col. L. Rev. 391, 394.

To put the matter another way, the General Mortgage Trustee here has both a senior position, on a par with the First Mortgage, and a junior position, behind the First Mortgage. The Commission has held that the senior position of the General Mortgage does not apply to as much property as the General Mortgage Trustee contended, but no one disputes that it does have a senior position, on a par with the First Mortgage, in respect of certain property. The fact that this property may be small in comparison with the property on which the First Mortgage has a senior position, does not justify disregarding it altogether, and giving the General Mortgage only a junior position, especially where the property on which it has a senior position is substantial in relation to the debts secured by the General Mortgage.

As respects the free cash, as well as the General Mortgage collateral free from the First Mortgage, there is also good authority that such free assets justify giving junior creditors some share in the prior lien bonds given on reorganization to senior encumbrances. (In re Barclay Park Corp., 90 F. (2d) 595, 597—C.C.A. 2nd.) In that case the court held that a plan was fair which, because of substantial assets free from the [693] first mortgage, subordinated the claims of the first mortgage bondholders to the extent of 25% of the principal to 25% of the claims of general creditors, and sub-

ordinated the first mortgage bondholders' claim for interest arrears to the entire principal of the general creditors' claims.

In order to be fair and equitable even on the legal basis which the Commission has adopted as respects disputed liens, the plan should give to General Mortgage bondholders a proportion of their claims in new income-mortgage bonds\* according to the proportion (approximately 40%) which the value of collateral on which the General Mortgage is a first lien (plus a fair proportion, at least, of the free cash) bears to the total amount of the general mortgage claims. The Trustee takes no position respecting the division as between the three creditors holding General Mortgage bonds of the new income-mortgage bonds or other securities which would be thus allocated. Nor does it in any way acquiesce in the preliminary determination of the Commission with respect to priority of lien on the Northern California extension, the equipment, or the non-carrier real estate mentioned above.

### CONCLUSION

The report of this honorable Commission dated October 10, 1938 and the plan of reorganization thereby approved should be modified so as to give to the holders [694] of General Mortgage bonds a

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\*Or the highest rank of such other securities as may be allotted to First Mortgage bondholders under any modified plan of reorganization.

fair proportion of their claims in new securities of the same type given to the First Mortgage bondholders under such plan.

Dated, December 9, 1938.

Respectfully submitted,

H. C. McCOLLOM,

ORRIN G. JUDD,

Attorneys for Irving Trust  
Company, as Trustee under  
General and Refunding  
Mortgage of Western Pa-  
cific Railroad Company.

[Endorsed]: Filed Oct. 5, 1939. [695]

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Before the  
Interstate Commerce Commission  
Finance Docket No. 10913.

In the Matter of

The Western Pacific Railroad Company,  
Debtor.

PETITION OF A. C. JAMES CO., FOR MODI-  
FICATION OF THE PROPOSED PLAN  
OF REORGANIZATION OF THE DEBTOR  
COMPANY, PROMULGATED BY THE  
COMMISSION BY ITS ORDER OF OCTO-  
BER 10, 1938, AND FOR A REHEARING

The petition of A. C. James Co., a secured credi-  
tor, respectfully shows as follows:

I. Your petitioner is a corporation organized and existing under, and by virtue of, the laws of the State of Delaware, with its registered office in the State of Delaware at No. 900 Market Street, Wilmington, Delaware.

II. Your petitioner is a creditor of the debtor company in the principal amount of \$4,999,800, together with unpaid accrued interest thereon at the rate of 5 per cent per annum from January 1, 1934, which unpaid interest to June 30, 1938 amounted to \$1,124,955, or an aggregate debt on the date specified of \$6,124,755. [697]

The consideration for said indebtedness was money loaned and advanced to the debtor company, now evidenced by three promissory notes of the debtor company, the principal amount, date, and date of Maturity of which are respectively as follows:

Principal Amount	Date	Maturity
(1) \$4,504,000	March 28, 1932	March 28, 1935
(2) 347,000	March 28, 1932	March 28, 1935
(3) 148,800	May 31, 1932	May 31, 1935

The promissory note for \$4,504,000, appearing at (1) above, was issued by the debtor company pursuant to authority granted by the Interstate Commerce Commission, in exchange for the Five Per Cent. Gold Debentures of the debtor company in like amount, issued under the Indenture dated as of July 1, 1930, made by and between the debtor company and the Chase National Bank of the City of New York, as Trustee. The debentures so ex-

changed evidenced cash advances, in like amount, which were made from time to time during the years 1931 and 1932, as follows:

February 27, 1931	\$1,000,000
March 26, 1931	200,000
April 20, 1931	400,000
May 25, 1931	530,000
June 20, 1931	995,000
August 25, 1931	309,000
October 20, 1931	600,000
November 25, 1931	120,000
January 29, 1932	350,000
Total	\$4,504,000

The promissory notes, appearing at (2) and (3) above, were issued by the debtor company against cash advances in like amount on the dates stated.

[698]

The notes now held by your petitioner are secured as follows:

By \$6,249,500 principal amount of the debtor's General and Refunding Mortgage Bonds, issued under an Indenture dated as of January 1, 1932, executed by the debtor company to The Chase National Bank of the City of New York, as Trustee, which General and Refunding Mortgage Bonds were deposited with and are now held by your petitioner; except that \$2,000,000 principal amount of said General and Refunding Mortgage Bonds, at the request of the debtor company, were delivered by your petitioner to The Railroad Credit Corporation, to be held by said The Railroad Credit Cor-

poration as additional collateral against advances made to the debtor company by said The Railroad Credit Corporation; your petitioner retaining all its rights as lienor in and to said \$2,000,000 principal amount of the debtor company's General and Refunding Mortgage Bonds, subject only to the prior rights which have accrued to The Railroad Credit Corporation as first lienor from the acts of the parties set forth.

The advances made by your petitioner to the debtor company were all made in 1931 and 1932, and were, in their entirety, applied to the costs of constructing the Northern California extension of the debtor company, which was built under the lien of the First Mortgage of the debtor company, and is an important source, present and prospective, of earnings to the debtor company.

A proof of claim was duly filed by your petitioner in the proceedings for reorganization of the debtor company, now pending in the District Court of the [699] United States for the Northern District of California, Southern Division (No. 26591-S).

By an order, entered August 20, 1935, by the District Court of the United States for the Northern District of California, Southern Division, in the proceeding for the reorganization of the debtor company (No. 26591-S), the above described claim of your petitioner was classified as a separate and distinct class for the purposes of Section 77 of the Bankruptcy Act, as amended.

III. On or about February 7th, 1936, the debtor company filed with the Commission a proposed Plan

of Reorganization. Hearings on the debtor company plan were initiated on March 23, 1936 and continued from time to time until December 9, 1936. In the course of these proceedings two additional plans were filed by parties to the proceeding, one of such plans having been submitted on behalf of your petitioner. On or about August 1, 1937, a proposed Report of the Bureau of Finance of the Commission was submitted to the parties to the proceeding. All parties, including your petitioner, filed exceptions thereto. On November 17, 1937, a hearing was held on these exceptions before the full Commission. On October 10, 1938, the Report and Order of the Commission, upon which a rehearing is now asked by your attorney, was handed down. This Report and Order of October 10, 1938, promulgates a Plan of Reorganization for the debtor company, which Plan differs in substantial respects from any of the plans theretofore submitted by parties to this proceeding.

IV. Your petitioner is advised and believes, and therefore alleges on information and belief, that the proposed Plan of Reorganization, as promulgated by [700] this Commission by its Report and Order of October 10, 1938, contains provisions which (a) are substantially prejudicial to its interests as a creditor and would, if put into effect, confiscate its property and deprive it of the protection assured to it, as a creditor, under the law of the land, (b) are incompatible with the public interest, and (c) are not authorized by Section 77 of the Federal Bank-

ruptcy Act, as amended, in the following respects and for the following reasons, among others:

A. The Plan promulgated by the Commission in its Report and Order of October 10, 1938, is objected to by substantially all classes of creditors.

Section 77 of the Bankruptcy Act was intended by Congress to expedite voluntary reorganizations of railroads. The Commission knows, or could readily learn by inquiry, that no single class of creditor or stockholder approves or accepts the plan which it has promulgated. Yet this plan, if certified by the Commission to the Court, will, under the provisions of Section 77 of the Bankruptcy Act, be submitted in due course to the creditors for acceptance or rejection.

We have here the extraordinary situation of the Commission, after almost eleven months of deliberation, promulgating a plan for ultimate submission to the creditors; for approval under the mechanics of Section 77, which plan is known at the outset to be objectionable to all, or substantially all, classes of creditors.

The Commission may fully understand the views of the interested creditors, but may construe the 1935 amendments to Section 77, and especially subsection (e), as amended, as contemplating the making effective of a plan of reorganization of a railroad property which [701] is not acceptable to any of the creditors or to the stockholders. Subsection (e), as amended, contains an express proviso, as follows:

“Provided, That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms, \* \* \*

It may well be doubted whether Congress intended the quoted language as giving to the Commission and the Court the legal power to impose a plan of reorganization by coercion of all interested parties.

However, even though such were the legislative intent (and even though such intent could constitutionally be made effective), your petitioner respectfully submits that the Commission has completely failed to make the essential finding of fact upon which any such action by the Court could be taken.

The language quoted above from subsection (e) of Section 77 is immediately followed by that paragraph which provides the basis upon which the Commission shall find a value for the property being reorganized, to effect the purposes of the section.

The necessary implication is that there can be no coercion of entire classes of creditors, except on the basis of a finding by the Commission of the valua-

tion of the property against which their claims are asserted. Any other construction of subsection (e) would fly in the face of common sense and put substantial property [702] rights at the mercy of the current economic theories of an administrative body, without any effective protection through judicial review. How can the Commission or the Court decide what is "fair and equitable treatment" of admitted claims of creditors except upon the basis of a valuation of the property in which such creditors have an interest?

If the Commission does contemplate that the plan promulgated in its Report and Order of October 10, 1938 will be rejected by all classes of creditors, or, for that matter, by any one class of creditors, and subsequently be made effective by action of the Court under subsection (e) of Section 77, loss of time and additional expense to the parties in this proceeding will necessarily result if the Commission fails to incorporate in its report, at the time of certification of a plan to the Court, a finding as to valuation of the property in which the various classes of creditors claim an interest. This question of valuation is discussed below in other connections.

B. Your petitioner is prejudiced by the improper preferences proposed by the Commission for the benefit of Reconstruction Finance Corporation and The Railroad Credit Corporation.

Your petitioner advanced to the debtor company during 1931 and 1932 (during the depression) a total of \$4,999,800. The advances were in cash and

enabled the debtor company to complete the Northern California Extension, now a factor of admitted importance in the earning power of the Company. Your petitioner was given, under Commission authorization, General and Refunding Mortgage bonds of the debtor company as [703] collateral, to the extent of 125% of principal amount of its advances.

At about the same time, functioning under Section 5 of the Reconstruction Finance Corporation Act, the Commission exacted from the debtor company, \$10,750,000 face amount of such General and Refunding Mortgage bonds, as *part* collateral for advances of the Reconstruction Finance Corporation, which advances now stand at \$2,963,000 principal amount. In other words, disregarding other substantial collateral, the Reconstruction Finance Corporation holds General and Refunding Mortgage bonds of the debtor, as collateral, to the extent of about 363% of the principal amount of its advances, as compared with the 125% furnished to your petitioner.

Carrying forward this solicitude for a coordinate agency of the Federal government, the Plan promulgated in the Report and Order of the Commission of October 10, 1938, gives to the Reconstruction Finance Corporation \$9,025,550 in common stock (using the \$100 per share value assigned by the Commission in its Report to this non-par value common stock) for its debt, principal and interest, of \$3,612,181, while \$3,556,000 of such common stock

is given to your petitioner, for its debt, principal and interest, of \$6,124,755.

In addition, the Reconstruction Finance Corporation is to be permitted, under the terms of the Commission Report and Order, to retain the collateral for its claim which was furnished it by others than the debtor company. How this can be done against a protest of the party furnishing this other collateral is not made clear, but it does indicate the extraordinary solicitude of the Commission for the interests of the Reconstruction Finance Corporation. [704]

Your petitioner recognizes the special equities which affect the claim of the Reconstruction Finance Corporation. Public moneys were advanced through the Reconstruction Finance Corporation to the debtor company during the depression in an endeavor to save it from default on its fixed debt obligations. The moneys so advanced were used almost entirely to pay interest to the First Mortgage bondholders or to discharge taxes which were liens prior to the claims of the First Mortgage bondholders. The equities arising from the facts mentioned should be recognized in a reorganization (as should similar special equities affecting the claims of the Railroad Credit Corporation and your petitioner), but at the expense of all creditors of the debtor company, including First Mortgage bondholders, and not solely at the expense of your petitioner.

The legal aspects of the theory upon which the Commission seeks to justify its preferential treatment of the Reconstruction Finance Corporation claim as against the similar claim of this petitioner are discussed in Point II of the brief filed by this petitioner with the Commission on September 27, 1937.

Stated simply, the situation is this: The General and Refunding Mortgage bonds which are held by the Reconstruction Finance Corporation and your petitioner in widely varying ratios were never "issued" bonds. They were authorized by the Commission solely for use as collateral. The mere fact that the Commission required more pieces of paper to be issued to the Reconstruction Finance Corporation than to the petitioner, on loans made almost concurrently and for equally meritorious purposes, cannot multiply the debt claim of the Reconstruction Finance Corporation at the expense of [705] your petitioner. If debt claims could successfully be increased by the multiplication of pieces of paper taken from a necessitous debtor, the entire basis upon which the activities of loan companies in this country are conducted would be changed.

Even though the General and Refunding Mortgage bonds held by the three secured creditors were to be regarded as true collateral furnished by the debtor company (which it clearly is not) greater distributions to one creditor than to another could be justified only upon a showing that the value of the property of the debtor company in which its

creditors claim an interest is less than the total amount of the secured creditors claims.

Not only does the Report of the Commission fail to find that the value of the property of the debtor company is less than the total amount of the secured creditors' claims, but it expressly authorizes (Report, p. 60) \$80,660,400 of securities for distribution to the First Mortgage bondholders and secured creditors, whose aggregate claims, principal and interest, on June 30, 1938, amounted to only \$73,522,463.

Clearly, using approved capitalization as a yardstick, there is enough to discharge the debt claims of the three secured creditors (Reconstruction Finance Corporation, Railroad Credit Corporation and A. C. James Co.), and hence no legal ground for a preference between them based on the relative amount of General and Refunding Mortgage bonds held by them.

It should be noted, however, that the Report of the Commission, at page 62, states that since it proposes to distribute only 159,462 shares of the non-par-value stock to the three secured creditors, "it would be inequitable to distribute such stock in the proportion that each claim bears to the total amount of such stock." [706]

The Commission's premise for such statement is, "Having found that 159,462 shares of common stock available for distribution are inadequate in value to satisfy the aggregate claims of the parties, \* \* \*"

But the only value assigned by the Commission to this common stock is the value of \$100 per share (Report, p. 60). So you have \$15,946,200 of common stock to allot among three creditors whose aggregate claims, principal and interest, amount, as of June 30, 1938, to \$12,317,842. Obviously, there is no inadequacy.

Your petitioner respectfully submits that no plan of reorganization is equitable or legally sustainable which gives the Reconstruction Finance Corporation in common stock two and one-half times the amount of its actual debt, while giving to your petitioner only a little more than half the amount of its actual debt.

The theory upon which the Commission seeks to sustain preferential treatment of the Reconstruction Finance Corporation as against your petitioner leads it to give a like preferential treatment as against your petitioner to The Railroad Credit Corporation. To this preferential treatment your petitioner likewise objects, and on like grounds.

C. The Plan promulgated in the Commission's Report and Order of October 10, 1938, is invalid in that it fails to recognize the claims of the general creditors.

The debtor company has two general creditors. On June 30, 1938, the date used in the Report and Order of October 10, 1938, the debtor company owed to The Western Pacific Railroad Corporation for advances on open account the principal sum of \$5,766,309, and for interest to that date the sum of \$1.

843,061. The debtor [707] company also owed the Western-Realty Company on the date, for like advances, the sum of \$50,000 principal amount, and \$10,417 of interest. No provision is made in the Plan promulgated by the Commission for these claims of general creditors.

In the Commission's Order there appears an express finding that these claims are without value (Par. 10, Order). There is nothing in the record before the Commission which supports such a finding. The valuation of the property of the debtor company, made by the Commission under Section 19a, amounts, with additions at cost to June 30, 1938, to approximately \$145,000,000. As suggested by Commissioner Miller in his dissenting opinion, if all reasonable deductions for depreciation were applied, the net valuation would amount to at least \$120,000,000. The aggregate of principal and interest as of June 30, 1938, of the secured claims, coming ahead of these general creditors (including equipment trusts and trustees' certificates), was only \$85,488,580, leaving an excess of about \$35,000,000, if weight is to be given the Section 19a valuation.

It should further be noted that it is rare indeed that a finding can be made that the claim of a general creditor against a corporation is completely without value, when the debtor company has \$5,481,640.99 in current assets (Report and Order, p. 9).

Nor can the Commission sustain its finding of no

value for the interests of the general creditors by reference to the capitalization which the Commission is prepared to approve for the reorganized company. In its Report (p. 60) it expressly authorizes \$80,660,400 of securities of the reorganized company for distribution among the creditors (other than holders of equipment [708] trusts and trustees' certificates). The aggregate claims of the First Mortgage bondholders and the secured creditors (such claims having priority as to the bulk of the assets of the debtor company) amount, as of June 30, 1938, to only \$73,522,463. This leaves a clear excess for the general creditors of \$7,137,937.

The cancellation of the interests of the general creditors in the property can be justified, if at all, only upon a finding both as to the value of that part of the property of the debtor company which is subject to liens, and as to the value of that part of the property of the debtor company which is clearly free from any lien. These findings the Commission has not made.

D. The plan promulgated by the Commission is invalid in failing to recognize any value for the stockholders in the property.

As stated under point C above, the 19a valuation, with additions to cost to June 30, 1938, amounted to upwards of \$145,000,000. Deducting accrued depreciation, there would be a clear residue of more than \$120,000,000. The debts of the debtor company, as of the same date, aggregate, principal and interest, \$93,158,367. On the basis of the 19a valua-

tion there is an excess of approximately \$27,000,000 for the equity.

However, the Commission is careful in its Report to designate the Section 19a valuation as a valuation "for rate purposes" and, by implication, to suggest that, for the purpose of Section 77 of the Bankruptcy Act, a valuation may be based purely on earning capacity.

There are several factors which should be noted in this connection. [709]

In the first place, subdivision (a) of Section 77 of the Bankruptcy Act, in stating the basis upon which valuations should be made, does not permit them to be grounded solely on earning power, but definitely requires conformance to the law of the land in valuation cases. A valuation made purely on an earnings basis would not, we are advised, furnish a proper and lawful basis upon which to legally terminate the interest of the stockholders in the debtor company.

In the second place, the record before the Commission shows, and the Report of the Commission recognizes, that the earnings record of the debtor company for the past ten years has been influenced by factors which make it difficult to gauge future earnings on the basis of the earnings of the immediate past. Some of these factors were: (a) the expenditure of approximately \$18,000,000 during the period in question on the physical rehabilitation of the property of the debtor company; (b) the construction during that period of the Northern

California Extension, an addition which has greatly changed the traffic relationships of the debtor company and, admittedly, largely increased its future earning power; and (c) the construction of the Dot-zero Cut-Off and the resultant increase of through traffic which will be routed to it from its principal eastern connection.

In the third place, it should be noted that the Commission has completely failed in its Report to make any valuation or appraisal for the property of the debtor company (other than its reference to the Section 49a valuation) either on the basis of earnings or any other basis. It has, to be sure, asserted a willingness to approve a capital structure not to exceed an aggregate amount of \$93,726,517, but of this total \$31,370,300 is [710] represented by the arbitrary allocation of a value of \$100 a share to the no par value stock which is to be authorized. Your petitioner is advised that no par value stock has the essential and inherent characteristic of representing merely a fractional interest in property, and there is no more reason (except on the basis of a valuation of the property represented by such fractional shares) to allocate a value of \$100 a share to proposed no par value stock than \$200 a share, or \$25, or \$10.

Accepting, for the present purpose, the total value assigned by the Commission to the securities it proposes to authorize (\$93,726,517), as reflecting its view as to an appropriate valuation of the property for the purposes of Section 77 of the Bankruptcy

Act, it is difficult to see how, on the record before the Commission, a reviewing court could sustain such valuation.

Not only is there a complete disregard of its Section 19a valuation, but the Commission, in its Report, is quite explicit as to how it arrives at the limitations it puts on the capitalized value of the property of the debtor company. The Report (page 40) states that Section 77 of the Bankruptcy Act provides that an approved plan shall be "compatible with the public interest". It states that "the public interest is not defined"; but interprets the phrase to require, among other things, "that the capitalization should not exceed a conservative appraisal of the assets to be taken over by the reorganized company and that proposed charges, whether fixed or contingent, be within its probable earning power."

On this basis the Commission proceeds to state, on page 41, quite a different proposition to the effect that consideration should be given to investment in the property of the debtor company "only to the extent that such investment is justified by the probable earnings reasonably foreseeable for the future".

Without making any appraisal of the assets of the debtor company, however, the Commission then moves forward to the premise that it ought not to authorize a capital structure for a reorganized company which includes capital stock on which dividends are not reasonably likely to be paid. At page 51 of the Commission's Report, it states:

“The capitalization of the reorganized company must be maintained within strict limits if any material return on its capital stock is to be expected and the shares of its stock are not to become mere tokens for stock market speculation.”

There would seem to be an obvious missing middle in the above logical sequence. The doctrine that property rights should be taken away if one cannot foresee an immediate material return is the more extraordinary in this day and age when money in the bank and even short term government bonds are often held or purchased on a zero or even minus interest basis. On the same theory you could take away from the owners probably a quarter to a third of the improved real estate property in the City of New York without (in theory) violating due process of law.

Why should the Commission's theory, that a “material return” is to be assured or expected on the capital stock of the reorganized company, take the place of the “conservative appraisal of the assets to be taken over by the reorganized company”, to which the Commission refers on page 40 of its Report? [712]

And why, above all, should the substantial rights of the stockholders in the property be disregarded, and in effect confiscated, on the basis of a mere theory of capitalization? Section 77 of the Bankruptcy Act may carry some ambiguities, but it cer-

tainly was not a condemnation statute. The phrase that shares of stock should not become "mere tokens for stock market speculation" was an impressive phrase, as first used by Senator Wheeler, and has a real significance, but it is hardly an adequate substitute for an appraisal, or an adequate basis for the appropriation of the property rights of the stockholders of the debtor company.

Your petitioner urges that any plan of reorganization certified by the Commission to the Court should recognize the interest of the stockholders of the debtor company, even though such recognition be given through the issue of no par value common stock, on which the Commission may not be able to say with confidence that dividends will be paid in the next five, ten, or twenty years.

E. Other objections to the Plan promulgated by the Commission.

In addition to the substantial features of the proposed plan of the Commission to which your petitioner objects, there are other less basic, but equally objectionable, features of the proposed plan.

For instance, the Commission Plan provides for \$10,000,000 of first mortgage bonds, protected by a first lien upon all the assets of the company, and yet provides that these bonds should be income bonds for the first five years. [713]

It may fairly be assumed that all parties to the proceeding are prepared to accept a drastic limitation by the Commission, under the mandate of Section 77 of the Bankruptcy Act, upon the fixed

charges of the reorganized company so as to bring such charges well within the scope of its earning power. It is probable that no one party to this proceeding would reject a plan solely because it forced all existing creditors to accept income obligations for the entire existing debt. If, however, the property cannot, as a matter of sound financing, sustain a fixed charge of \$400,000 a year upon the \$10,000,000 of new money used to rehabilitate the property during the past three years, the Commission might well dismiss the proceeding under Section 77 and invite a proposal for the discontinuance of service to the public and a liquidation of the property of the debtor company.

The result of any such requirement in the plan is to make it quite impracticable to market the proposed 4% income bonds to the public during the first five years of their existence. In effect, it makes the Reconstruction Finance Corporation the only possible purchaser of such bonds and cannot but be detrimental to the credit of the reorganized company.

So too, objection might properly be made to the provisions for the selection of a Reorganization Committee and to other incidental features of the Commission Plan.

#### F. Practical Considerations.

If the plan of reorganization, in its present form, as set forth in the Report and Order of the Commission of October 10, 1938 is certified by the Commission to the [714] Court, it is at least doubtful.

whether the reorganization of the debtor company under Section 77 will be expedited.

Under the unnecessarily drastic treatment of the interests of the creditors and of the stockholders it may be assumed: (a) that the secured creditors will necessarily ask the Court for a determination on the question of conflict of lien between the First Mortgage and the General and Refunding Mortgage, (b) that your petitioner will ask the Court for a determination of the value of the property of the debtor company (or a remission to the Commission for such valuation in the first instance) as a basis for asserting that the rights of general creditors are to be dealt with on the basis of actual debt, represented by the relative amounts of money advanced to the debtor company, and not on the basis of the number of pieces of paper issued by the debtor company to them, ostensibly as collateral, (c) that The Western Pacific Railroad Corporation as a general creditor and the Western Realty Company as a general creditor will ask the Court for a determination of value of the property of the debtor company as a basis for their assertion of a right to be recognized as creditors of the debtor company in any plan of reorganization, and (d) that The Western Pacific Railroad Corporation as owner of all the stock of the debtor company will ask the Court for a valuation of the property with a view to recognition of its interests.

If the Plan in its present form were to be certified to the Court and immediately submitted to the parties to the proceeding for a vote as to acceptance,

it may safely be assumed that substantially all the creditors will vote to reject the Plan. [745]

If, therefore, it is the desire of the Commission to expedite the reorganization of the debtor company, some other or different course should be followed.

If the Commission is prepared to assert, in all proceedings under Section 77 of the Bankruptcy Act, that the interests of creditors must be determined solely on the basis of the prospective earning power of the property of the debtor company, then the case of The Western Pacific Railroad Company constitutes a poor test case. It would be far better for the Commission to reject the various plans submitted to it by the debtor and creditors in this proceeding, and to postpone the approval of a plan of reorganization for the debtor company until it shall have had an opportunity to demonstrate what its real earning power is under normal conditions.

Only during the summer of 1938 did the rehabilitation program of the debtor company, which has involved the expenditure of approximately \$16,000,000 in the last three years, reach its completion. This rehabilitation program had an obvious and substantial effect on the apparent earning power of the debtor company, both because it involved charging directly to operating expenses more than half the moneys so spent, and, also, because of the disruption of normal traffic and resultant increase of transportation expenses.

Furthermore, the Northern California Extension is only now in a position to demonstrate its full contribution to earnings of the debtor company, as

it has taken a considerable time for the flow of traffic to become firmly established.

If, however, the Commission is prepared to recognize that theories of capitalization ought not to be solely [716] determinative of the property rights of the creditors and is prepared to deal with the problem of the reorganization of the debtor company on a realistic basis, your petitioner believes that a plan of reorganization can be evolved which will meet with the acceptance of the necessary proportion of all parties at interest. While it is believed that the working out of such a plan acceptable to the parties would be clearly facilitated if the Commission were able, through suitable designees, to proceed by means of informal conferences with the parties at interest, it seems possible that an appropriate plan could be evolved by the parties themselves if freed from the limitations imposed by the somewhat drastic theories of capitalization which have heretofore been urged by the Commission.

In the event a further attempt is made to evolve, in the proceeding before the Commission, a plan acceptable to parties, your petitioner suggests that the Commission invite or require a full representation before it of the various parties at interest. In the proceedings thus far held there has been no formal representation before the Commission of the general creditors or the stockholders. Moreover, the First Mortgage bondholders have been represented only by a committee of Institutional Bondholders, and not by a public committee approved by the Commission under subsection (p) of Section 77

of the Bankruptcy Act. The importance of this is that, while the insurance companies may well hold approximately one-third of the outstanding First Mortgage bonds, their interests are in certain respects quite different from the interests of individual holders of First Mortgage bonds. For instance, the various plans submitted by the Institutional Bondholders Com- [717] mittee in this proceeding, show on their face that considerable importance is attached to holding in that Committee effective control of the reorganization, and of the reorganized company which may emerge from such reorganization. A committee acting for all the First Mortgage bondholders, qualified by the Commission under subsection (p) of Section 77 of the Bankruptcy Act, might well take a quite different point of view upon this question. Likewise, the extent and the manner of funding unearned interest, in connection with the reorganization, has quite a different aspect for the insurance company bondholder than for the individual bondholder, because of the different methods of income tax accounting applicable. In these and other respects, the Institutional Bondholders Committee is not an entirely adequate spokesman for the First Mortgage bondholders.

G. Reservation of right to file specific objections to any modified plan.

Your petitioner, having in mind that such plan as may finally be approved by the Commission and certified to the Court may differ in substantial re-

spects from the Plan of Reorganization, as set forth in the Report and Order of October 10, 1938, necessarily reserves the right to file with the Court specific objections to such plan as may be certified to the Court by the Commission, even though such objections might have been urged to the Plan of October 10, 1938, and are not.

Wherefore, your petitioner prays the Commission, in the alternative, that it either modify the Plan ~~set~~ forth in the Report and Order of October 10, 1938 in the [718] respects indicated above, or reopen the matter for a reasonable period in order that a plan acceptable to the interested parties may be evolved. Your petitioner further prays that in the event the Commission grants an oral argument upon this, or other petitions for rehearing on the Report and Order of October 10, 1938, that your petitioner be granted the right to be heard in person or by counsel at that time. And for such other and further relief as may seem to this Commission just and proper.

Dated: December 8, 1938.

A. C. JAMES CO.,

By WILLIAM W. CARMAN,

Vice-President.

ROBERT E. COULSON,

Attorney for Petitioner,

Office and P. O. Address,

40 Wall Street,

New York, N. Y. [719]

State of New York,  
County of New York,—ss.

William W. Carman, being duly sworn, deposes and says that he is the Vice President of A. C. James Co. and as such is fully authorized to make this affidavit and that the foregoing statement of facts is true except as to those matters therein stated to be upon information and belief and as to those matters he believes it to be true.

**WILLIAM W. CARMAN.**

Subscribed and sworn to before me this 8th day of December, 1938.

[Seal] **JOHN K. BIRCH.**

Notary Public, Kings County, Kings County Clerk's No. 40, Kings County Register's No. 160, Certificate filed in New York County, New York County Clerk's No. 146, New York County Register's No. 0B125.

Commission expires March 30, 1940. [720]

**Certificate of Service**

I hereby certify that on December (8), 1938, I served the foregoing document on all parties of record by mailing a true copy thereof to each of said parties.

**ROBERT E. COULSON**

[Endorsed]: Filed Oct. 5, 1939. [721]

Before the  
Interstate Commerce Commission

Finance Docket No. 10913

In the Matter of  
The Western Pacific Railroad Company  
Reorganization.

PETITION FOR MODIFICATION OF THE  
COMMISSION'S REPORT AND ORDER  
DATED OCTOBER 10, 1938 ON BEHALF  
OF FREDERICK H. ECKER, JOHN W.  
STEDMAN AND REEVE SCHLEY, AS AN  
INSTITUTIONAL BONDHOLDER'S COM-  
MITTEE :

Come now Frederick H. Ecker, John W. Stedman and Reeve Schley, as a Committee representing a group of institutional holders of First Mortgage Bonds of The Western Pacific Railroad Company (hereinafter referred to as the Committee, the Railroad Company being hereinafter referred to as the Debtor), intervenors in the above-entitled proceeding, and respectfully petition the Commission to modify its Report and Order entered herein under date of October 10, 1938, as hereinafter set forth, and to grant a rehearing herein, and in support of said petition respectfully show:

I.

The Plan of Reorganization approved by the Report and Order entered herein under date of October 10, 1938 (received by the parties hereto Oc-

tober 15, 1938), which Plan is hereinafter called the Commission's Plan, is, as to several of its details, unacceptable to the Committee and, in the opinion of the Committee, will be unacceptable to a substantial majority of the holders of the Debtor's existing First Mortgage Bonds. The reasons for the objections of the Committee to the Commission's Plan are hereinafter in Article III set forth. The Committee is advised that the Commission's Plan is also unacceptable to each of the other classes of creditors and stockholders of the Debtor. Accordingly, in the opinion of the Committee and its counsel, any effort to consummate the Commission's Plan in the form embodied in said Report and Order will result in vigorous opposition from all classes of creditors and stockholders and will indefinitely delay the reorganization of the Debtor. On the other hand, most of the details of the Commission's Plan as to which the Committee has objection seem to affect only private rights of the parties and not the public interest, and as to such objections it would seem that they can be obviated without in any wise adversely affecting any matter of public interest. In so far as such objections go to questions in which there is a public interest, in the opinion of the Committee and its counsel, the modifications of the Commission's Plan required to obviate such objections are themselves all in the public interest.

## II.

In the hope that the parties of record herein could and would agree upon a plan for the reorganization of the Debtor which might reasonably be expected to obtain the approval of the Commission and to be acceptable to all classes of creditors and stockholders of the Debtor, the Committee and its counsel, after October 18, 1938, entered into negotiations with the representatives of all such classes of creditors and stockholders.

Said negotiations failed to result in such an agreement primarily, in the opinion of the Committee and its counsel, because recognition of the rights of junior creditors and stockholders in a manner satisfactory to them would necessitate an aggregate capitalization larger than [724] that which said Report of the Commission indicated was likely to be approved by the Commission, and also would require, if the claims of the present bondholders were also to be given recognition in a manner satisfactory to them, the creation of a larger amount of Preferred Stock than said Report indicated the Commission was likely to approve. Should the Commission be willing so to increase the amount of Preferred Stock to be issued in the reorganization as to permit allocation of Preferred Stock for the claim of the existing First Mortgage Bondholders for interest, and at the same time slightly increase the number of shares of new Common Stock, without par value, to be issued, and also make the modifications as to the character of the

new securities hereinafter suggested, it is believed that unanimous agreement between the parties of record might still be effected.

Lacking such unanimous agreement, however, the Committee has developed modifications of the Commission's Plan which, while conforming substantially to the general capital structure provided for by the Commission's Plan, obviate the objections of the Committee to that Plan. These modifications of the Commission's Plan have been embodied in a complete plan, a copy of which is hereto annexed as Exhibit A (hereinafter called the Committee's Modified Plan) which, the Committee is advised, has the approval of Reconstruction Finance Corporation (hereinafter called RFC). The Committee believes that its Modified Plan "is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders;" and can, as a practical matter, be consummated without undue delay. [725]

### III.

The objections of the Committee to the Commission's Plan, and the manner in which those objections are obviated by the Committee's Modified Plan, are as follows:

1. The Commission's Plan violates the rule laid down by the United States Supreme Court in *Northern Pacific R. Co. v. Boyd*, 228 U. S. 482, and cases following that case (hereinafter called the Boyd case rule), by allotting to creditors junior to the Debtor's existing First Mortgage Bondholders (hereinafter referred to as the junior creditors) new securities which give the junior creditors participation in the reorganized property in priority to full recognition of the existing priorities of the Debtor's existing First Mortgage Bonds.

The claim of the existing First Mortgage Bonds as of July 1, 1938, aggregated \$61,204,621, all of which, as correctly found by the Commission's Report and Order, is secured by a lien upon substantially all the Debtor's property prior to the lien of any other of the Debtor's creditors. By the terms of the existing First Mortgage that claim bears fixed interest at the rate of 5% per annum, or \$3,060,231 per annum.

The Commission's Plan requires the following diminution of the present First Mortgage Bondholders' existing rights to annual income and to assets:

(a) Upon no part of their claim are the existing First Mortgage Bondholders hereafter to receive fixed interest;

(b) in respect of that part of their claim representing 40% of the principal amount of the existing First Mortgage Bonds, the holders of said Bonds are to receive an annual rate of return of 4%, or 20% less than that to which

they are presently lawfully entitled; such rate is to be contingent upon [726] income; and to the extent that deficiencies of income exceed three years' interest at the reduced rate, the bondholders are wholly deprived even of the reduced rate of return;

(c) as to that part of their claim representing 60% of the principal of the existing First Mortgage Bonds, the holders of said Bonds are to be transferred from a creditor position to that of Preferred Stockholders. While their annual rate of return remains unchanged at 5%, such return is to be dependent wholly upon annual income and to the extent of any income deficiency in any year, is lost forever. Moreover, dividends on the Preferred Stock (though cumulative if earned) need not be paid unless the Board of Directors of the New Company deems it advisable so to do; and

(d) as to that part of their claim representing the accrued and unpaid interest on their bonds, the holders of the existing First Mortgage Bonds are not only to be transferred from a position of creditor to the position of stockholder, but the priority of that portion of their claim against the assets of the Debtor is to be taken away by the allotment of Common Stock in which, as will hereafter be pointed out, junior creditors are given allotments on a basis more favorable than the allotment made to the holders of existing First Mortgage Bonds.

The Commission's Plan provides no compensating factors (such as conversion or participating rights) to compensate the holders of existing First Mortgage Bonds for the drastic diminution of their rights, both as to income and as to principal, imposed upon them by the foregoing provisions of the Commission's Plan. In other words, the existing First Mortgage Bondholders are required, without being compensated therefor, to make large [727] sacrifices in the new securities which they receive, which sacrifices redound to the benefit of the junior creditors.

The Committee's Modified Plan obviates the foregoing objections of the Committee in the following manner:

(a) The interest rate upon the Income Bonds is made  $4\frac{1}{2}\%$ , thus reducing the minimum sacrifice of annual income on this part of the bondholders' claim from 20% of their present annual return to 10% of that return; and to compensate both for that sacrifice and for the contingent character of the interest and the three year limitation upon its cumulative character, the Income Bonds are made convertible into Common Stock of the New Company at the rate of 20 shares of Common Stock for each \$1,000 bond:

(b) while the annual rate of dividends upon the Preferred Stock provided for in the Commission's Plan has not been changed, the Committee's Modified Plan, in order to compensate for the fact that the new Preferred Stock is

wholly non-cumulative except if earned, provides that, after dividends shall have been paid or declared or set apart for payment on the new Common Stock at the rate of \$3 per share in respect of any year, each share of new Preferred Stock shall be entitled to share equally with each share of new Common Stock in any dividends paid or declared or set apart for payment in respect of such year; and

(c) the Committee's Modified Plan provides for an allocation of Common Stock whereby no junior creditor shall receive Common Stock for its claim upon a basis (i. e., at a price) more favorable than the basis (i. e., the price) at which Common Stock is allotted to holders of existing First Mortgage Bonds in respect of that part of their prior claim for which new Common Stock is allotted. The objection of the Committee with respect to the allocation of Common Stock under the Commission's Plan and the method of obviating that objection under the Committee's Modified Plan is further explained in the next succeeding paragraph 2 of this Article III.

2. The Commission's Plan erroneously treats General and Refunding Mortgage Bonds of the Debtor pledged to secure the notes to RFC, Railroad Credit Corporation (hereinafter called RCC), and A. C. James Company (hereinafter called

ACJ), as if such Bonds constituted a debt of the Debtor, and, as debt, were entitled to participation in the reorganization. In fact said Bonds have never been issued, have never become obligations of the Debtor, and constitute in law and in equity, not debt, but solely a method of dividing among the holders of the real debts (the notes, with interest, held by RFC, RCC and ACJ), for which said Bonds are pledged as collateral, whatever security may remain in the value of the Debtor's property after full payment of the existing First Mortgage Bonds, both principal and interest.

That security, as correctly found by the Commission, is junior to the First Mortgage. Hence no amount of multiplication of evidences of the security can lift the debt which it secures to a position entitling that debt to better treatment than is accorded any part of the debt represented by the First Mortgage Bonds.

The Commission's plan allots 3.13 shares of new Common Stock to that part of the existing First Mortgage Bondholders' claim representing the accrued and unpaid interest to July 1, 1938, amounting to \$241.72 per \$1,000 First Mortgage Bond. This makes the price at which new Common Stock is so allotted \$77.25 per share.

The Commission's Plan allots 90,255 $\frac{1}{2}$  shares of new Common Stock to the RFC claim, a debt aggregating to July 1, 1938, for both principal and interest, \$3,612,181, [729] and no more. This makes the price at which new Common Stock is so al-

lotted \$40 per share, or a price to a creditor junior to the First Mortgage Bonds of but 51.8% of the price at which the stock is allotted to the senior First Mortgage Bonds.

The Commission's Plan allots 33,646½ shares of new Common Stock to the RCC claim, a debt aggregating to July 1, 1938, for both principal and interest, \$2,580,906, and no more, and which, because fewer General and Refunding Mortgage Bonds are pledged per \$1,000 of the claim than are pledged to secure the RFC note, is entitled to still less favorable treatment than the RFC note. The price at which new Common Stock is thus allotted to RCC is \$76.70 per share, again less than the price at which the stock is allotted to the senior First Mortgage Bonds.

The practical result of the allocation of the new securities by the Commission's Plan is that, when income distributable upon the new securities shall in any year have provided in full for the interest upon the RFC's present junior claim, the income so distributed to holders of existing First Mortgage Bonds will have recouped them to the extent of but 81% of the annual income to which they are presently lawfully entitled for that year.

Furthermore, when under such allocation the income distributable to the new securities held by existing First Mortgage Bondholders in any year fully recoups such Bondholders for the annual income to which they are presently lawfully entitled,

the income received upon the new securities allotted to the RFC claim will aggregate  $2\frac{1}{7}$  times the annual interest to which the junior RFC claim is presently lawfully entitled.

The Committee's Modified Plan obviates these objections, as to RFC, by granting to RFC, in consideration of its provision of new money as hereinafter in Paragraph 3 of this Article III provided, treatment *pari passu* with holders of existing First Mortgage Bonds, and as to RCC, by allotting new Common Stock to holders of existing First [730] Mortgage Bonds, in respect of their claim, at the price of  $\$66\frac{2}{3}$  per share and to RCC, in respect of its claim, at the price of  $\$70$  per share.

The provision of the Commission's Plan that Common Stock must be allocated as between RCC and ACJ in proportion to the amounts of General and Refunding Mortgage Bonds held by them respectively as collateral is, in the opinion of the Committee and its counsel, correct, and such proportionate allocation as between said two creditors is adhered to in the Committee's Modified Plan.

It will be noted that under the Committee's Modified Plan the changed treatment of the RFC claim results in the RCC claim and the ACJ claim receiving more shares of new Common Stock than are allotted to them under the Commission's Plan.

3. The Commission's Plan provides no definite and practical method of raising the necessary  $\$10,000,000$  of new money and further violates the rule

of the Boyd case by giving to RFC, a junior creditor, the privilege of providing the new money upon terms which will presumably be more favorable than those afforded to the senior First Mortgage Bonds.

The Commission's Plan provides for the issue against \$10,000,000 of new money of \$10,000,000 First Mortgage 4% Bonds maturing in fifty years with interest contingent on income, but fully cumulative, for five years and thereafter fixed. Such bonds probably are not marketable at their principal amount and accrued interest under the conditions affecting railroad credit today. The Commission's Plan provides for an offer of the Bonds at that price to the junior creditors and existing First Mortgage Bondholders, but in neither case are such creditors required so to purchase their proportion of the New Bonds as a condition of their participation in the reorganization. As a practical matter, therefore, the rejection of such offer is certain and its rejection will not in any wise, under the Commission's Plan, diminish the participation of the rejecting creditor in the new securities issuable under that Plan. [731]

The alternative method for furnishing the new money provided by the Commission's Plan is that RFC shall make a loan, the terms of which as to interest rate, maturity, and security, are left wholly undisclosed. Presumably, the terms are to be more favorable than those offered by the Commission's Plan to the senior First Mortgage Bondholders.

This creates a further violation of the rule of the Boyd case, through its unjust discrimination against a senior creditor in favor of a junior creditor.

This objection is obviated by the Committee's Modified Plan (along with the objection referred to in paragraph 2 above in so far as it affects the discrimination in favor of RFC) by providing that RFC, in consideration of its furnishing the new money by purchasing at their principal amount and accrued interest \$10,000,000 4% First Mortgage Bonds having a maturity of 25 years and bearing fixed interest, shall receive, in respect of its present claim, treatment on the same basis as that received by holders of existing First Mortgage Bonds.

Under the conditions affecting railroad credit prevailing prior to January 1, 1938, the purchase upon such terms of said new First Mortgage Bonds would not, in the opinion of the Committee and its counsel, have afforded adequate consideration to support, as against holders of existing First Mortgage Bonds and other creditors of the Debtor, the treatment of the existing RFC note as thus contemplated. Under the conditions affecting railroad credit now prevailing, however, the purchase of said Bonds at said price will, in the opinion of the Committee and its counsel, furnish adequate consideration to support, as against both existing First Mortgage Bonds and existing junior creditors, such treatment of the RFC claim.

4. The Commission's Plan provides for a mandatory Capital Fund. In the opinion of the Committee and its counsel, this constitutes an undue restriction upon management and an undue prejudice to all holders of the new securities other than the new First Mortgage Bonds. The [732] Committee's Modified Plan therefore provides that appropriations to the Capital Fund shall be permissive.
5. The Commission's Plan rejected the proposal heretofore made by the Committee that the election of directors should be by cumulative voting in order to insure representation to all interests, and particularly to the holders of the new Preferred Stock, who will be chiefly the existing First Mortgage Bondholders. The record shows that ACJ, a junior creditor, also has substantial control of the Debtor's stock and also holds a substantial amount of existing First Mortgage Bonds. The Committee does not believe that it is fair or equitable to create a voting system under which a junior creditor who will receive for his junior claim Common Stock having a remote interest in income will, because he also owns or controls a minority of the existing First Mortgage Bonds, be able to elect the entire Board of Directors of the New Company. Accordingly, the Committee's Modified Plan provides for the election of directors by cumulative voting. It will be noted that under such a system of voting the present junior creditors, including ACJ, as holders of new Common Stock will also be assured

representation on the Board of Directors of the New Company.

6. The Commission's Plan does not create a capital structure adequate to provide for future capital expenditures and at the same time maintain a sound character.

The Commission's Plan provides that new First Mortgage Bonds in excess of the \$10,000,000 to be issued in the reorganization for new money shall not be issued against future capital expenditures unless the income of the New Company available for fixed charges in a period of 12 consecutive calendar months within the 18 calendar months immediately preceding the date of authentication and delivery of the bonds equals or exceeds  $11\frac{1}{2}$  times the fixed charges including interest on the bonds then applied for. It provides no authorized Income Mortgage Bonds for use in future financing.

[733]

The foregoing provisions will prevent the issue of fixed charge obligations in periods of low earnings when the New Company would be unable to borrow except by the use of fixed interest bearing obligations (thus tending to induce insolvency) and, on the other hand, will permit the use of fixed interest bearing obligations during periods of high earnings when the capital structure should be so arranged as to encourage financing through Income Mortgage Bonds or Stock upon a reasonable basis.

A study of the earnings record and security issues of carriers now in receivership or Section 77 pro-

ceedings and of carriers generally regarded as having sound capital structures indicates that the provisions of the Commissioner's Plan would not have prevented the exaggerated debt of many of the present insolvent carriers, while, on the other hand, they would have resulted in the insolvency of several carriers whose capital structures generally are regarded as sound and which the Commission has certified are not in need of reorganization. (See Debtor's Brief dated May 31, 1938, before the Bureau of Finance in Chicago, Milwaukee, St. Paul and Pacific Reorganization, Finance Docket No. 10,882, pages 66-70.)

The Committee's Modified Plan obviates this objection by provisions which are the result of long study by representatives of institutional and other bondholders in this and other reorganization proceedings and which, it is believed, have now been so worked out as to avoid objections made to somewhat similar provisions in other reorganization cases.

7. The Commission's Plan provides that the Reorganization Committee which shall carry out the reorganization shall be composed of one person named by the First Mortgage Bondholders, one person by RFC, RCC and ACJ as a group (which, in view of the amount of collateral held by RFC, means RFC), and one person by the purchaser of the new First Mortgage Bonds (which, as a practical matter, means RFC). [734]

While there can be no doubt that RFC is entitled to representation on the Reorganization Committee, particularly if it provides the new money, the Committee does not believe that its position entitles it, and certainly the junior creditors as a class are not entitled, to two-thirds of the Reorganization Committee, as against the holders of approximately \$62,000,000 senior claim of the existing First Mortgage Bondholders.

The Committee's Modified Plan therefore provides that the Reorganization Committee shall be composed of three persons designated by the holders of existing First Mortgage Bonds in such manner as the Commission may prescribe, one, by RFC and one, by RCC and ACJ jointly.

It will be noted that the Committee does not seek to name the representatives of the First Mortgage Bondholders to serve as the members of the Reorganization Committee but leaves the manner of their selection to the Commission's determination. The Committee, however, is insistent that a method of electing representatives of the First Mortgage Bondholders shall be adopted by the Commission which shall result in representation of the First Mortgage Bondholders by those whose interest lies solely in the First Mortgage Bonds and not by those whose real interest lies in a junior position.

8. The Commission's Plan does not provide adequate means for executing the Plan and, by eliminating the provisions originally suggested by the Committee for carrying out the Plan through a

sale at an upset price to be fixed by the Court, will create a cloud on title of the New Company and make questionable the marketability of the new First Mortgage Bonds, even to RFC.

The Committee's Modified Plan obviates this objection through a provision for a sale at an upset price to be fixed by the Court which is materially different in form from that originally suggested by the Committee, and which the Committee believes avoids all the objections made to similar provisions in previous Reports of the Commission and its Bureau of Finance. [735]

The provision now contained in the Committee's Modified Plan

(a) is operative only after the confirmation of the Plan;

(b) is optional with the Court and not mandatory;

(c) creates no "coercion" against junior creditors, confining the possibility of such "coercion" to the invocation of the power of the Court under subdivision (e) of Section 77 to confirm the Plan as against classes of creditors having an interest in the property but not, as a class, accepting the Plan. The Committee's Modified Plan, in this latter respect, conforms to the Commission's overruling of the Committee's objection to such unqualified invocation of subdivision (e);

(d) gives to any dissenting class of creditors and to the stockholders a privilege (not given

in the absence of such a provision) either to buy the Debtor's property at such a sale or to procure other buyers and obtain the benefit of any price other buyers will pay. This privilege in the present case is not illusory, whatever might be said in other reorganizations, for the ~~three classes of junior creditors~~ and the sole stockholder, which have not already expressed approval of the Committee's Modified Plan, are three large corporations and between them undoubtedly financially able to provide funds, or obtain their provision by others, sufficient to purchase the property at such a sale; and

(e) contemplates the sale of the property as an entirety and not piece-meal in a manner to break up the Western Pacific System.

The inclusion of such a provision for sale of the Debtor's property is necessary if the reorganization is not [736] to be delayed indefinitely. The junior creditors and sole stockholder who are seeking to bring about such delay naturally oppose the inclusion in any Plan of such a provision because they know that, lacking such a provision, no acceptable title can be created in the New Company and that probably its new securities will not be marketable. Accordingly, by refusing to permit the inclusion of such a provision, expressly contemplated by subdivision (b) (5) of Section 77, the Commission's Plan facilitates obstruction, not only by those secured junior creditors who admittedly have an interest in the property, but also by the unsecured

creditors and sole stockholder whose interests the Commission has found to have no value.

9. The effective date of the Commission's Plan is July 1, 1938, a date already well past, in effect requiring the waiver by creditors of their interest accrued from that date to the present time. The Committee's Modified Plan substitutes January 1, 1939.

10. The Commission's Plan does not seem to the Committee and its counsel to be a complete Plan dealing with all the matters which are required to be dealt with before securityholders are asked to vote upon the Plan. Indeed, it is the impression of the Committee and its counsel that the Commission's Plan does not purport to be such a complete Plan. Since the Committee's Modified Plan does purport to be a complete Plan, it deals with various matters which are not dealt with at all by the Commission's Plan, but in a manner which it is believed will be unobjectionable both to the Commission and to the other classes of securityholders.

#### IV.

The Committee respectfully suggests that, in order to simplify and expedite the submission to the securityholders of the Plan, as finally approved, and the subsequent [737] proceedings under Section 77, the Commission should approve the Committee's Modified Plan in the form submitted herewith, with such modifications, if any, as the Commission may deem necessary or desirable; and that, if the Com-

mission deems any modifications necessary or desirable, the specific language of such modifications be incorporated in such Plan after conference with representatives of all the parties herein, so that there may be one complete document which constitutes the Plan, and that, so far as possible, unintentional erroneous expression may be avoided.

Wherefore, the Committee prays that the Report and Order of the Commission, dated October 10, 1938, be modified by the approval of the Committee's Modified Plan; that, if the Commission shall deem such a hearing necessary, a rehearing before Division 4 of the Commission be granted in the above-entitled proceeding; and that the Commission enter such further order or orders as to it may seem just and reasonable.

Dated New York, N. Y., December 8, 1938.

FREDERICK H. ECKER,

JOHN W. STEDMAN,

REEVE SCHLEY.

As a Committee representing  
a group of institutional  
holders of First Mortgage  
Bonds of The Western Pa-  
cific Railroad Company.

By LITTLETON GROOM,

Secretary.

CRAVATH, DE GERSDORFF,

SWAINE & WOOD,

Attorneys for the Committee, as aforesaid, No. 15  
Broad Street, New York City. [738]

State of New York,  
County of New York—ss.

Littleton Groom, being duly sworn, deposes and says:

That he is the Secretary of the Committee referred to in the foregoing petition; that he has read the foregoing petition and knows the contents thereof; that the same are true as stated, except as to matters and things, if any, stated to be on information and belief; and that as to those matters and things he believes them to be true.

LITTLETON GROOM

Subscribed to in my presence and sworn to before me this 8th day of December, 1938.

(Notarial Seal) SAUL SCHNEIDERMAN,  
Notary Public, Kings County, Kings Co. Clk's No.  
1149, Reg. No. 9486. N. Y. Co. Clk's No. 1,  
Reg. No. 9 S 816.

Commission expires March 30, 1939, [739]

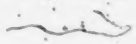


EXHIBIT A

The Western Pacific Railroad Company

PLAN OF REORGANIZATION

Dated January 1, 1939

Effective Date, January 1, 1939

Proposed by the Committee representing  
Institutional Bondholders [740]

List of Certain Abbreviated Terms

A. C. J.—A. C. James Company.

Committee.—The Committee representing certain institutional holders of First Mortgage Bonds of the Company, acting under a group agreement dated as of September 1, 1936, and consisting of Frederick H. Ecker, Chairman, John W. Stedman and Reeve Schley.

Bankruptcy Trustees.—The Trustees now or hereafter operating the properties of The Western Pacific Railroad Company by appointment of the Court in the Reorganization Proceeding.

Commission.—The Interstate Commerce Commission.

Company or Debtor.—The Western Pacific Railroad Company.

Consummation of the Plan.—The transfer to the New Company, to the extent contemplated by the Plan, of the properties and assets of the Company.

**Court.**—The District Court of the United States for the Northern District of California, Southern Division.

**Effective Date of the Plan.**—The date from which interest shall run on the new securities provided in the Plan, namely, January 1, 1939.

**First Mortgage Bonds.**—Bonds issued under the First Mortgage dated June 26, 1916, from the Company to First Federal Trust Company and Henry E. Cooper, as Trustees (Crocker First National Bank and Samuel S. Armstrong, Successor Trustees) designated as the First Mortgage.

**General and Refunding Bonds.**—Bonds issued under the Mortgage dated January 1, 1932, from the Company to The Chase National Bank of the City of New York as Trustee (Irving Trust Company, now Successor Trustee), designated as the General and Refunding Mortgage.

**New Company.**—The corporation, whether the Company or a new corporation, which shall acquire the greater part of the properties now held by the Bankruptcy Trustees and issue the new securities provided for by the Plan.

**Plan.**—This proposed plan of reorganization.

**Reorganization Committee.**—The Reorganization Committee appointed as herein provided.

**R. C. C.**—The Railroad Credit Corporation.

**R. F. C.**—Reconstruction Finance Corporation.

**Reorganization Proceeding.**—The pending proceeding under Section 77 of the Bankruptcy Act, as amended, before the Court involving the properties

of the Company (Docket No. 7,004), including also (unless the context otherwise indicates) the related proceeding before the Commission (Finance Docket No. 10,008).

**W. P. Corp.**—The Western Pacific Railroad Corporation, sole stockholder of the Company. [741]

I.  
Present Capital Liabilities as of January 1, 1939  
(including unpaid interest)

		Fixed Annual* Interest
Equipment Trusts, Baldwin Lease and Pullman Contract	\$ 2,750,050	\$ 94,202
First Mortgage 5% Bonds due 1946:		
Principal	\$49,290,100	2,464,505
Unpaid Interest	13,143,777	
Total	62,433,877	
Notes to R. F. C. (secured by pledge of \$10,750,000 General and Refund- ing Bonds; also by a second lien upon \$2,000,000 General and Refund- ing Bonds pledged to secure Note to R. C. C.):		
Principal	\$ 2,963,000	177,780
Unpaid Interest	899,870	
Total	3,862,870	
Note to R. C. C. (Secured by pledge of \$4,000,000 General and Refund- ing Bonds; also by a second lien upon \$10,750,000 General and Refund- ing Bonds pledged to secure the Note to R. F. C.; also by a first lien upon the rights of the Company under the Marshaling and Distribut- ing Plan of 1931):		
Principal	\$ 2,445,610	24,456
Unpaid Interest	146,503	
Total	2,592,113	
Note to A. C. J. (Secured by pledge of \$4,249,500 of General and Refund- ing Bonds. \$2,000,000 of the General and Refunding Bonds pledged to secure the Note to R. C. C. were initially pledged to secure the Note to A. C. J. and by it repledged as additional collateral with the R. C. C.)		
Principal	\$ 4,999,800	249,990
Unpaid Interest	1,249,950	
Total	6,249,750	
Unsecured Obligations to W. P. Corp.**		
Principal	\$ 5,817,543	290,877
Unpaid Interest	1,992,096	
Total	7,809,639	
Preferred Stock	28,300,000	
Common Stock	47,500,000	
	\$161,498,299	\$3,301,810*

Unpaid Interest .....	13,143,777	
Total .....		62,433,877
Notes to R. F. C. (secured by pledge of \$10,750,000 General and Refunding Bonds; also by a second lien upon \$2,000,000 General and Refunding Bonds pledged to secure Note to R. C. C.):		
Principal .....	\$ 2,963,000	177,780
Unpaid Interest .....	899,870	
Total .....		3,862,870
Note to R. C. C. (Secured by pledge of \$4,000,000 General and Refunding Bonds; also by a second lien upon \$10,750,000 General and Refunding Bonds pledged to secure the Note to R. F. C.; also by a first lien upon the rights of the Company under the Marshalling and Distributing Plan of 1931):		
Principal .....	\$ 2,445,610	24,456
Unpaid Interest .....	146,503	
Total .....		2,592,113
Note to A. C. J. (Secured by pledge of \$4,249,500 of General and Refunding Bonds. \$2,000,000 of the General and Refunding Bonds pledged to secure the Note to R. C. C. were initially pledged to secure the Note to A. C. J. and by it repledged as additional collateral with the R. C. C.)		
Principal .....	\$ 4,999,800	249,990
Unpaid Interest .....	1,249,950	
Total .....		6,249,750
Unsecured Obligations to W. P. Corp.**		
Principal .....	\$ 5,817,543	290,877
Unpaid Interest .....	1,992,096	
		7,809,639
Preferred Stock .....		28,300,000
Common Stock .....		47,500,000
		\$161,498,299
		\$3,301,810*

\*Without interest on interest accrued and unpaid on First Mortgage Bonds, on R. F. C., R. C. C. or A. C. J. Notes or on W. P. Corp. Advances; and computing interest on the R. C. C. Note at 1%, the New York Federal Reserve Bank discount rate as of November 1, 1938.

\*\*Includes advances from Western Realty Company—\$50,000 principal; \$11,667 interest.

Fund shall be applied to the redemption of the Income Mortgage Bonds, Series A, on the next succeeding interest payment date. All bonds so acquired shall be cancelled and no bonds may be issued to refund any such bonds.

**D. Issue of Additional Income Mortgage Bonds.**

Income Mortgage Bonds, in addition to those to be issued in the reorganization, may be issued from time to time to refund outstanding Income Mortgage Bonds or, in lieu of First Mortgage Bonds, for the purposes and subject to the restrictions stated under "Issue of Additional First Mortgage Bonds" above, to the extent that First Mortgage Bonds are not issued for such purposes.

**E. Restrictions Designed to Encourage Future Financing Through Stock and Restrictions on Pledges.**

No Income Mortgage Bonds (other than those to be issued under the Plan) may be authenticated and delivered unless: (1) the New Company shall have contracted forthwith to sell or pledge such bonds and (2) the Board of Directors of the New Company, by resolution adopted by two-thirds of the entire number of directors, shall have determined that, in the opinion of the Board, taking into account market and all other relevant conditions at the time, it is impracticable to provide the amount of money needed (a) by the sale of Preferred Stock at a price which would give a current dividend return of 6% or less, or (b) by the

sale of Common Stock at a price (not less than \$50 per share) which would give a current dividend return (based on the regular dividend rate then in effect, or, if no regular dividend rate is in effect, on the average rate at which dividends shall have been paid during the last twelve calendar months) of 6% or less.

The Income Mortgage will also contain a covenant substantially to the effect that the excess of the aggregate principal amount of all Income Mortgage Bonds under pledge at any one time over the principal amount of all indebtedness so secured shall not exceed 10% of the aggregate principal amount of all Income Mortgage Bonds then authenticated and uncanceled.

#### F. Modification of Income Mortgage.

The Income Mortgage will provide, within conditions and limits to be therein prescribed, for the modification and alteration thereof and of the rights and obligations of the New Company and of the holders of the Income Mortgage Bonds thereunder, at any time by the concurrent action of the New Company and of the holders of not less than 66 $\frac{2}{3}$ % in aggregate principal amount of the bonds then outstanding; provided, however, that no such change or modification shall alter or impair the obligation of the New Company to pay the [747] principal of any bond without the consent of the holder of such bond. In the event of any unification of the properties of the New Company with the

## II

### Proposed Capitalization of the New Company

#### 1. Summary

The capitalization proposed herein for the New Company is substantially as follows:

Title of Issue	Presently Issued	Interest or Dividends
Undisturbed Equipment Trusts, Baldwin Lease and Pullman Contract	\$ 2,750,950	\$ 94,202
First Mortgage 4% Bonds, Series A, due 1964	10,000,000	400,000
Total Annual Fixed Charges		494,202
Capital Fund		500,000
Income Mortgage 4½% Bonds, Series A, due 2014	20,901,240	940,556
Total Funded Debt	33,651,290	
Total Annual Charges (fixed and contingent) and Capital Fund		1,934,758
Income Mortgage Sinking Fund		104,506
Participating Preferred 5% Stocks, Series A (par value \$100)	31,351,900	1,567,595
Total Annual Charges, Capital Fund, Sinking Fund and Preferred Dividend Requirements		3,606,859
Common Stock (without par value)	287,025 shs.	
Capitalization (Common at \$100 per share)	\$ 93,705,690	

Institutional Bondholders et al.

## 2. First Mortgage Bonds

## A. Lien of Mortgage.

The First Mortgage will be a lien, directly or through pledge of securities, subject only to liens upon equipment, on all the properties and assets owned by the New Company on the consummation of the Plan, including securities, equipment, and the equity in such equipment as is subject to equipment obligations. The First Mortgage will also be a lien on all similar property acquired by the New Company after the reorganization, except that (a) if the New Company shall acquire the properties of any other company (except a company which is a wholly owned railway subsidiary on January 1, 1939), constituting a Class I carrier as defined by the rules then in force of the Interstate Commerce Commission or other public regulatory bodies having jurisdiction at the time, such properties shall not be subject to the lien of the First Mortgage unless acquired in whole or in part by the use of First Mortgage Bonds or Income Mortgage Bonds, or moneys deposited under the First Mortgage or the Income Mortgage, and (b) if the New Company shall be consolidated with, or shall be merged into, or shall sell its assets substantially as an entirety to, any other company which at the time is a Class I carrier as defined as aforesaid, no properties theretofore owned or thereafter acquired by such other company shall be subject to the lien of the First Mortgage except properties thereafter acquired which shall be appurtenant or incident to

properties subject to the lien of the First Mortgage, or which shall be within the maintenance or replacement covenants of the First Mortgage, or which shall be acquired in whole or in part by the use of First Mortgage Bonds or Income Mortgage Bonds or moneys deposited under the First Mortgage or the Income Mortgage.

**B. Issue Limited—Sinking Fund if Certain Limits Exceeded.**

The amount of bonds issuable under the First Mortgage will be limited to \$50,000,000.

The First Mortgage will provide (1) that on each May 1 when the aggregate principal amount of First Mortgage Bonds outstanding shall equal or exceed \$20,000,000, the New Company will pay to the Trustee [743] under the First Mortgage as a Sinking Fund a sum equal to  $\frac{1}{2}$  of 1% of the maximum principal amount of First Mortgage Bonds theretofore at any one time authenticated and uncanceled; and (2) that on each May 1 when the aggregate principal amount of First Mortgage Bonds outstanding plus all other funded debt bearing fixed interest shall exceed either (a) 35% of the total capitalization of the New Company, determined as hereinafter provided, or (b) 50% of such total capitalization, less the principal amount of funded debt bearing contingent interest at the time outstanding, the New Company, in addition to the sums provided in Clause (1) of this Subdivision B to be paid, will pay into said Sinking Fund a sum equal to

50% of the Available Net Income of the next preceding calendar year that remains after providing for all Income Mortgage sinking funds and charges prior thereto (i. e., that remains after the deductions made pursuant to paragraphs (1), (2), (3), (4) and (5) of Subdivision G of Section 3 of this Article II; or after the provisions of said Subdivision G shall have ceased to be operative, 50% of net income as defined by the accounting rules or practice referred to in said Subdivision G). Such Sinking Fund shall be applied to the retirement of First Mortgage Bonds, by purchase in the open market or by call or tenders at not exceeding the redemption price (or in the case of bonds not redeemable, the principal amount and accrued interest), and whenever the amount in the Sinking Fund exceeds \$50,000 and First Mortgage Bonds are not tendered or cannot otherwise be purchased at less than their redemption price, the funds then in the Sinking Fund shall be applied to the redemption of new First Mortgage Bonds on the next succeeding interest payment date. All bonds so acquired shall be cancelled and no bonds may be issued to refund any such bonds. First Mortgage Bonds and Income Mortgage Bonds outstanding shall be deemed to include all bonds authenticated and delivered to the New Company which shall not have been cancelled or assured of retirement through the deposit of cash. Funded debt shall include an amount equal to the capitalized value, at 5% per annum, of fixed rents payable for leased roads, other than terminal or

bridge properties; but shall not include (a) obligations (other than mortgage bonds or equipment trust obligations) maturing not more than two years after their date, or (b) obligations of longer maturity secured by pledge of bonds having a lien on property of the New Company except to the extent, if any, by which the principal amount of such obligations exceeds the principal amount of such bonds so pledged. Bonds guaranteed by the New Company as to interest or principal or both (other than bonds of a terminal or bridge company) shall be included in funded debt, but, in case of a joint and several guaranty with other corporations, only to the extent of the New Company's basic proportion of the principal liability. There shall be included in determining total capitalization only (a) obligations constituting funded debt, (b) stock having par value, at such par value, and (c) stock without par value, at \$100 a share in case of the stock issuable under the Plan, and, in case of other stock, at the capital value at which such stock is carried on the books of the Company, not exceeding, however (except to the extent that earned surplus shall have been duly capitalized), the net amount received by the New Company on the issue thereof.

### C. Issue in Series

The First Mortgage Bonds may be issued from time to time in different series, subject to such limitations and restrictions as may be specified in the First Mortgage, payable on such date or dates, in

such denomination, bearing interest at such rates and containing such provisions in regard to redemption, conversion, taxes, place or places and money or moneys of payment, registration and sinking funds and having such other characteristics as may be prescribed by the Board of Directors of the New Company at the time of issue, but with respect to the lien of the First Mortgage all equally secured. So long as any First Mortgage Bonds, Series A, shall be outstanding no additional First Mortgage Bonds shall be issued having a maturity earlier than January 1, 1964.

D. Bonds of Series A to be Issued in Reorganization.

\$10,000,000 First Mortgage Bonds, Series A, are to be authenticated and issued in the reorganization for the purpose of providing the \$10,000,000 of new money required in the reorganization.\*

The Bonds of Series A shall be dated January 1, 1939, shall mature January 1, 1964, shall bear interest at the rate of 4% per annum, payable semi-annually, and shall be redeemable, in whole or in part, at any time [744] on thirty days' notice, at their principal amount and accrued interest, plus a premium of 3% of their principal amount if redeemed on or before December 31, 1941, 2½% if redeemed thereafter and on or before December 31, 1945, 2% if redeemed thereafter and on or before

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\*See Article III below.

December 31, 1949,  $1\frac{1}{2}\%$  if redeemed thereafter and on or before December 31, 1953, 1% if redeemed thereafter and on or before December 31, 1957, and  $\frac{1}{2}\%$  if redeemed thereafter and on or before December 31, 1960, and without any premium if redeemed on or after January 1, 1961.

E. Issue of Additional First Mortgage Bonds.

First Mortgage Bonds, in addition to those to be authenticated in the reorganization, may be authenticated from time to time: (a) to refund First Mortgage Bonds (excluding bonds issued solely by way of pledge, except as hereinafter provided) or outstanding obligations secured by First Mortgage Bonds to the extent so secured or obligations secured by prior lien on after acquired property; or (b) upon the deposit of new cash equal to the principal amount to be issued; or (c) to provide for, or to reimburse the New Company for, not exceeding 75% of expenditures made after December 31, 1938, but not more than three years prior to the date of such authentication (including expenditures for the acquisition or construction of new railroad equipment, free from other lien, but not including expenditures for the making of additions and betterments to equipment) which, under the accounting rules of the Interstate Commerce Commission or other federal regulatory bodies having jurisdiction in the premises, at the time in force, are properly chargeable to capital account; provided, however, that

(a) Except when bonds are authenticated in respect of new mileage (or securities representative thereof) or in respect of new equipment the said 75% shall be applied to the net amount of said capital expenditures after deducting therefrom, to such extent and on such basis as may be specified in the First Mortgage, credits to capital account after December 31, 1938;

(b) If any First Mortgage Bonds are authenticated or cash deposited under the First Mortgage is withdrawn to provide or reimburse for the acquisition of railroad equipment, a sinking fund shall be established (in addition to any other sinking fund then in effect for any series of First Mortgage Bonds) payable in equal annual instalments in an amount sufficient to retire (at par) within the expected efficient service life of such equipment (in no case to exceed fifteen years) a principal amount of First Mortgage Bonds equal to (1) the principal amount of bonds so authenticated or (2) the amount of deposited cash so paid;

(c) If any property is acquired subject to existing liens the amount of additional First Mortgage Bonds issuable therefor or issued to refund prior lien obligations thereon, together with the aggregate amount of existing liens to which such property is subject, shall not exceed 75% of the net cost thereof, including as part of such cost the amount of such existing

liens whether or not the indebtedness secured thereby is assumed by the New Company; and

(d) No bonds shall be issued on the basis of the acquisition of equipment under equipment trust obligations or any obligations for the deferred or serial payment of the purchase price for equipment, or on the basis of the retirement of any such obligations.

#### F. Restrictions Designed to Limit Future Financing through First Mortgage Bonds and Restrictions on Pledges.

The First Mortgage will contain a covenant substantially to the effect that no First Mortgage Bonds (other than those to be authenticated under the Plan) will be sold or pledged unless (1) the New Company shall have contracted forthwith to sell or pledge such bonds and (2) the Board of Directors of the New Company, by resolution adopted by two-thirds of the entire number of directors, shall have determined that, in the opinion of the Board, taking into account market and all other relevant conditions at the time, it is impracticable to provide the amount of money needed (a) by the sale of Income Mortgage Bonds having a maturity of twenty years or more at a price which would give a yield to maturity of 5% or less, or (b) by the [745] sale of Preferred Stock at a price which would give a current dividend return of 6% or less, or (c) by the sale of Common Stock at a price (not less than \$50 per share) which would give a current dividend return (based on the regular divi-

dend rate then in effect, or, if no regular dividend rate is in effect, on the average rate at which dividends shall have been paid during the last twelve calendar months) of 6% or less.

The First Mortgage will also contain a covenant substantially to the effect that the excess of the aggregate principal amount of all First Mortgage Bonds under pledge at any one time over the principal amount of all indebtedness so secured shall not exceed 10% of the aggregate principal amount of all First Mortgage Bonds then authenticated and uncanceled.

### 3. Income Mortgage Bonds

#### A. Lien of Mortgage.

The Income Mortgage shall constitute a lien, subject to the lien of the First Mortgage, upon all property from time to time subject to the lien of the First Mortgage.

#### B. Issuable in Series.

The Income Mortgage Bonds may be issued, without limit as to aggregate amount or within such limit as may be specified in the Income Mortgage, from time to time, in different series, subject to such limitations and restrictions as may be specified in the Income Mortgage, payable on such date or dates, in such denominations, bearing interest at such rates and containing such provisions in regard to accumulation of interest, redemption, conversion, taxes, place or places and money or moneys of payment, registration and sinking funds, and having

such other characteristics as may be prescribed by the Board of Directors of the New Company at the time of issue, but with respect to the lien of the Income Mortgage all equally secured. No interest shall be mandatorily payable on Income Mortgage Bonds of any series (except at maturity or redemption) except out of Available Net Income, as hereinafter provided.

C. Income Bonds, Series A, to be Issued in Reorganization.

\$20,901,240 of Income Mortgage Bonds, Series A, are to be authenticated and issued in the Reorganization, as set out in Articles IV and V below.

The Income Mortgage Bonds of Series A shall be dated January 1, 1939, shall mature January 1, 2014, shall bear interest at the rate of  $4\frac{1}{2}\%$  per annum, due and payable as hereinafter provided, and shall be redeemable, in whole or in part, on May 1 in any year, on thirty days' notice at their principal amount plus (a) full interest for the last preceding year and all unpaid accumulated interest for prior years and (b) interest at the rate of  $4\frac{1}{2}\%$  per annum from the last preceding December 31 to the redemption date.

The Income Bonds of Series A shall be convertible into shares of Common Stock, as at the time constituted, at any time at the rate of 20 shares per \$1,000 principal amount of such Bonds.

Interest on Income Mortgage Bonds, Series A, accruing for each calendar year shall (up to the

limits of accumulation hereinafter specified) become absolutely due as a debt on December 31 in such year, but shall be payable on May 1 of the next succeeding year or thereafter as provided below. Such interest shall be mandatorily payable (except as hereinafter provided) only out of Available Net Income of the New Company that remains after providing for the Capital Fund and charges prior thereto (i. e., that remains after the deductions made pursuant to paragraphs (1) and (2) of Subdivision G of Section 3 of this Article II). All interest that comes due and is not paid on the next following May 1 shall accumulate up to the maximum amount of  $13\frac{1}{2}\%$  at any one time, but not beyond. Accumulated interest shall be mandatorily payable (a) whenever, and to the extent that, there is Available Net Income for any subsequent year remaining after the deductions made pursuant to said paragraphs (1) and (2) of Subdivision G (in which case such amount shall be paid on the next following May 1), or (b) in any event (whether earned or not) at [746] the maturity or on redemption of the Income Mortgage Bonds of Series A. For the purposes of the two sentences next hereinabove payments of interest shall be considered as applied to interest accrued for the last preceding calendar year before being applied to accumulations. The Board of Directors of the New Company may at any time, in its discretion, pay any interest accrued on the Income Mortgage Bonds, Series A,

even if not earned, out of any funds lawfully available therefor.

The Income Mortgage will provide for the payment on May 1 of each year while any Income Mortgage Bonds, Series A, are outstanding of an instalment of Sinking Fund, if earned, as, and in the amount, hereinafter specified. Such instalment shall be payable only out of Available Net Income for the last preceding calendar year that remains after paying interest on outstanding Income Mortgage Bonds (i. e., that remains after the deductions made pursuant to paragraphs (1), (2) and (3) of said Subdivision G). The amount of such instalment shall equal (a)  $\frac{1}{2}$  of 1% of the maximum principal amount of Income Mortgage Bonds, Series A, theretofore at any one time authenticated and uncanceled, plus (b) an amount equal to interest on all Income Mortgage Bonds, Series A, theretofore purchased or redeemed out of the Sinking Fund, calculated at the rate paid on said May 1 upon outstanding Income Mortgage Bonds of Series A. Such accruals of the Sinking Fund instalments shall not be cumulative. The Sinking Fund shall be applied from time to time to the retirement of Income Mortgage Bonds, Series A, by purchase in the open market or by call for tenders at not exceeding their redemption price, and whenever the amount in the Sinking Fund exceeds \$50,000 and Income Mortgage Bonds, Series A, are not tendered or cannot otherwise be purchased at less than their redemption price, the funds then in the Sinking

properties of any other company, the modifications hereinabove authorized may include provisions excluding in whole or in part the earnings from such other properties in determining Available Net Income and providing for the determination of such Available Net Income without the maintenance of separate accounts.

#### G. Determination and Application of Available Net Income.

Available Net Income shall be determined for each calendar year beginning with the year 1939, and continuing thereafter, so long as any Income Mortgage Bonds remain outstanding. When no Income Mortgage Bonds remain outstanding, the provisions of this Subdivision B shall cease to be operative.

Available Net Income for each such calendar year shall be determined by deducting all fixed charges of the New Company and its wholly owned railway subsidiaries accrued during such calendar year from the consolidated income of the New Company and its wholly owned railway subsidiaries available for fixed charges for such calendar year (determined in accordance with the accounting rules of the Interstate Commerce Commission or other analogous Federal authority having jurisdiction in the premises at the time in force, or, to the extent not governed by such accounting rules, in accordance with sound accounting practice), provided, however, that if the New Company shall not come

into ownership and possession of the properties now operated by the Bankruptcy Trustees on or before January 1, 1939. Available Net Income for any period after January 1, 1939, until the New Company comes into ownership and possession of such properties shall be computed as if the New Company had come into such ownership and possession on January 1, 1939 and had issued, as of that date, the new securities issuable under the Plan, other than the \$10,000,000 of new First Mortgage Bonds, Series A, and in lieu of interest on such Bonds there shall be charged the amount of interest actually accruing during such period upon any then outstanding Trustees' Certificates or other obligations issued to provide funds for rehabilitation purposes.

Available Net Income shall be ascertained for each such calendar year, as the accounts shall be stated on the books of the New Company during such calendar year, without adjustments, except that: (1) in determining Available Net Income there shall not be deducted any amounts from the proceeds of the Trustees' Certificates issued for rehabilitation purposes, notwithstanding that under the accounting rules hereinbefore mentioned such expenditures may be chargeable as operating expenses; (2) if in respect of any calendar year the Available Net Income is a deficit, the amount of such deficit may, in the discretion of the Board of Directors of the New Company, be carried forward and be deducted in determining Available Net In-

come for the succeeding calendar year or calendar years until such deficit (or accumulated or remaining deficits) be extinguished by earnings which in the absence of such deficit or deficits, would be Available Net Income; and (3)<sup>2</sup> debits or credits to adjust income in prior years shall be treated as income items for the year in which entered on the books whether cleared through income or profit and loss accounts, so far, but only in so far, as such debits and credits reflect cash receipts or disbursements in the year in which they are entered on the books.

Available Net Income for each calendar year shall be applied to the following purposes and in the following order:

(1) To the creation, if and when the aggregate principal amount of First Mortgage Bonds outstanding shall equal or exceed \$20,000,000, of the Sinking Fund provided for in Clause 1<sup>o</sup> of Subdivision B of Section 2 hereinabove, in an amount up to, but not exceeding, in respect of any calendar year,  $\frac{1}{2}$  of 1% of the maximum principal amount of First Mortgage Bonds theretofore at any one time authenticated and uncanceled.

(2) If the Board of Directors of the New Company in its discretion shall so determine, Available Net Income of each calendar year may be applied to the creation of a Capital Fund to be applied to, or to provide for, or to reimburse the treasury of the New Company for, Capital Investments, as defined by the Interstate Commerce Commission Clas-

sification of Income, Profit and Loss and General Balance Sheet Accounts for Steam Roads, Accounts Nos. 701 Investment in road and equipment, 702 Improvements on leased railway property and 705 Miscellaneous physical property (or advances to subsidiaries for expenditures which, [748] if made directly by the New Company in respect of its owned or leased properties, would be charged to said accounts), or such substituted accounts as may at the time be in effect, to the extent that such Capital Investments have been made or contracted for during such calendar year or within three months thereafter, and including therein (but only to the extent that such payments during such calendar year shall exceed depreciation of equipment charged against income for such calendar year) payments made for new equipment, or initial and principal payments upon equipment leased under equipment trusts or purchased under conditional sale agreements and instalments of sinking fund provided for by paragraph (b) of Subdivision E of Section 2 of this Article II (relating to First Mortgage Bonds issued for equipment), provided, however, that

(a) The amount set aside in the Capital Fund out of Available Net Income of any calendar year shall not exceed \$500,000 in respect of any calendar year, or such lesser sum as may be required, together with unappropriated accumulations in the Fund as of the close of the calendar year prior to that for which the

payment is to be computed, less charges for additions and betterments during said calendar year for which payment is to be computed, to bring the total in the Fund to \$1,000,000; provided, however, that the Capital Fund shall not exceed \$1,000,000 at any one time.

(b) The Capital Fund may be applied only to such part of the cost of Capital Investments as hereinabove defined as remains after deducting from such cost all retirements of roadway and structures charged against income in such calendar year:

(c) To the extent that expenditures are so provided for or reimbursed out of the Capital Fund, the Company shall not thereafter have the right to issue any bonds or other evidences of indebtedness or any stock ranking, as to either assets or dividends, in priority to, or on a parity with, the Preferred Stock of Series A to capitalize or reimburse such expenditures; provided, however, that such expenditures (if for purposes for which First Mortgage Bonds or Income Mortgage Bonds may be issued) may, within such limits, if any, as may be specified in the First Mortgage or the Income Mortgage, be used to supply, in whole or in part, the excess of capital expenditures required to be certified under either such mortgage over the principal amount of the bonds that may be issued under the terms thereof; and

(3) Any then remaining Available Net Income for any calendar year shall be applied to the payment on the next succeeding May 1, of interest on the then outstanding Income Mortgage Bonds (not including any thereof then held in any sinking fund) accrued during the last preceding calendar year, and of any accumulated unpaid interest thereon.

(4) Any then remaining Available Net Income for any calendar year shall be applied, so long as any Income Mortgage Bonds, Series A, are outstanding, to the payment on the next succeeding May 1, of the sinking fund instalment provided for in Subdivision C of this Section 3 (relating to Income Mortgage Bonds, Series A):

(5) Any then remaining Available Net Income for any calendar year may be applied to the creation of a sinking fund for Income Mortgage Bonds of series other than Series A, if any such sinking fund shall have been provided for at the time of the creation of any such series.

(6) Any then remaining Available Net Income for any calendar year shall be applied to the payment on the next succeeding May 1 of the instalment, if any, then due under the sinking fund provisions of Clause (2) of Subdivision B of Section 2 hereinabove (relating to First Mortgage Bonds when outstanding in excess of certain limits).

(7) Any then remaining Available Net Income for any calendar year may be applied to any proper corporate purpose of the New Company (except

dividends on the new Common Stock), including if and to the extent that such dividends shall be declared by the Board of Directors of the New Company, the payment of dividends upon the Preferred Stock in respect of such year and of any accrued and unpaid cumulative dividends on the Preferred Stock; such dividends to be paid, except as hereinafter provided, on such date or dates in the next succeeding year as may be specified in the Certificate of Incorporation or By-Laws of the New Company, or in the certificates for the Preferred Stock. [749]

(8) Any then remaining Available Net Income for any calendar year may be applied to any proper corporate purpose of the New Company, including (but only after all accrued and unpaid cumulative dividends on the Preferred Stock to the end of such year shall have been paid, or declared and set apart for payment) dividends on the Common Stock.

No interest need be paid on Income Mortgage Bonds if the amount to be paid is less than  $\frac{1}{4}$  of 1%. Any excess available for interest but not paid because of the foregoing provision shall be reserved and added to the income available for interest on the Income Mortgage Bonds for the next succeeding calendar year.

If there are outstanding Income Mortgage Bonds of different series, the amount applicable to interest on such bonds shall be distributed among the respective series in proportion to the unpaid inter-

est at the time accumulated on the bonds of such series, respectively.

Dividends may be paid on stock of any class (subject to the relative rights of the several classes of stock) out of the income of any calendar year prior to the close of such calendar year if, but only if, prior to the declaration of such dividends, the Board of Directors shall have determined that the Available Net Income for such year applicable for the purposes specified in the foregoing paragraphs (1), (3), (4), (5) and (6) will be more than sufficient to pay the amounts payable out of such Available Net Income pursuant to said paragraphs and such amounts shall have been deposited in trust for the purposes specified in said paragraphs. Dividends on Common Stock may be so declared only if, prior to such declaration, the Board of Directors shall have determined that the applicable part of Available Net Income for such year will be more than sufficient to pay the amount hereinabove specified for dividends (including accumulations) on the Preferred Stock and such amount shall have been deposited in trust for the purpose of paying such dividends.

#### 4. Preferred Stock

##### A. Authorized Issue.

There will be authorized 750,000 shares of Preferred Stock, each of the par value of \$100, of which 313,519 shares of Series A are to be issued in the

reorganization as set out in Articles IV and V below.

The additional authorized Preferred Stock not issued in the reorganization will be issuable from time to time in the discretion of the Board of Directors of the New Company, but (unless for purposes for which First Mortgage Bonds might otherwise have been issued) only after the concurring vote or consent of the holders of a majority of the outstanding Preferred Stock. So far as permitted by law, such additional Preferred Stock may be of Series A, or of any other series, **one or more**, and Preferred Stock of any such other series may bear dividends at such rate, cumulative or non-cumulative, may be redeemable or non-redeemable, convertible, or non-convertible, and may have such other rights and privileges and be subject to such limitations and restrictions, as may be from time to time determined by the board of directors prior to the issue of Preferred Stock of any such other series. If there are outstanding shares of Preferred Stock of different series, the earnings applicable to dividends thereon shall be apportioned among the respective series in proportion to the dividends accumulated on the shares of such series respectively.

#### B. Preference on Liquidation.

In any liquidation or winding up of the New Company, whether voluntary or involuntary, the Preferred Stock shall be entitled to receive, out of the assets of the New Company, its par value,

plus any accrued and unpaid cumulative dividends thereon, plus such premium, if any, as may be specified for any series, before any distribution shall be made on the Common Stock, but shall not be entitled to any further participation in such assets.

#### C. Voting rights.

Holders of Preferred Stock shall be entitled to one vote per share on all matters, except that in elections of directors, which shall be by cumulative voting, each holder of stock of either class shall be entitled to as many votes per share as the number of directors to be elected. [750]

The New Company shall not, without the vote or consent of the holders of at least two-thirds in par value of the outstanding new Preferred Stock, (1) create or permit to be created any mortgage or other lien upon any of its properties, excepting the new First Mortgage, the new Income Mortgage or purchase money liens (including equipment obligations) upon property hereafter acquired, given for not more than 75% of the purchase price of such property; (2) create or issue any bonds, notes or other evidences of indebtedness maturing more than two years from their date, except new First Mortgage Bonds and new Income Mortgage Bonds and except purchase money obligations given for not more than 75% of the purchase price of property hereafter acquired; (3) create any stock ranking, either as to assets or dividends, in priority to, or on a parity with, the new Preferred Stock, or

(4) permit any subsidiary, all of whose stock except directors' shares, shall be owned by the New Company, to create any mortgage or other lien upon any of its properties or issue any such bonds, notes or other evidences of indebtedness (except purchase money liens or obligations limited as aforesaid), or issue any additional stock of any class, unless the obligations secured by such mortgage or other lien or such other obligations or such stock shall be acquired by the New Company.

D. Preferred Stock, Series A.

The Preferred Stock, Series A, shall be entitled to receive all accumulated unpaid dividends and current dividends at the rate of 5 % per annum in respect of any calendar year before any dividends shall be paid or declared or set apart for payment on the Common Stock in respect of such year. Such dividends shall be cumulative to the extent earned in any calendar year but not paid; but such dividends shall otherwise be non-cumulative. For the purposes of the next preceding sentence hereinabove, Preferred Stock dividends shall be considered to be earned in any calendar year to the extent covered by the Available Net Income for such year that remains after providing for prior charges (i.e., that remains after the deductions made pursuant to paragraphs (1), (2), (3), (4), (5) and (6) of Subdivision G of Section 3 of this Article II); or after the provisions of said Subdivision G shall have

ceased to be operative, to the extent covered by net income (as defined by the accounting rules or practice referred to in said Subdivision G).

After dividends shall have been paid or declared or set apart for payment, on the new Common Stock at the rate of \$3 per share in respect of any year, each share of Preferred Stock, Series A, shall be entitled to share equally with each share of new Common Stock in any dividends paid or declared or set apart for payment, in respect of such year.

The Preferred Stock, Series A, shall be redeemable, in whole or in part, at any time at its par value plus accrued and unpaid cumulative dividends, and proportionate dividend for the current year.

The holders of Preferred Stock, Series A, shall not have any preemptive right to subscribe to any additional issues of stock of any class or of securities convertible into stock of any class.

### 5. Common Stock

There will be authorized 1,000,000 shares of Common Stock, without par value, of which 287,025 shares are to be issued in the reorganization as set forth in Articles IV and V below and 418,025 shares shall be reserved for the conversion of Income Mortgage Bonds, Series A.

Holders of Common Stock shall be entitled to one vote per share on all matters except that directors shall be elected by cumulative voting as aforesaid.

So far as permitted by law, any vote or consent

by the holders of Common Stock, authorizing the issuance of additional shares of stock of any class or of securities convertible into stock of any class, may waive on such terms and conditions, if any, as may be specified in such vote or consent, the preemptive right of all the holders of shares of Common Stock to subscribe to such additional shares or securities. [751]

### III.

#### Reconstruction Finance Corporation and Provision of New Money

\$10,000,000 of new money is required by the New Company for the purpose of retiring Trustees' Certificates issued to provide for the expenditures under the 1936, 1937 and 1938 rehabilitation program. Said \$10,000,000 in new money is to be provided for by the sale at par and accrued interest to R. F. C. (subject to approval and authorization of the Interstate Commerce Commission and the delivery to R. F. C. of a legal opinion satisfactory to it as to the validity of the acquisition by the New Company of title to the properties of the Debtor and the validity of the new First Mortgage Bonds, Series A, and the new First Mortgage) of the \$10,000,000 of First Mortgage 4% Bonds, Series A, due 1964, to be issued in the reorganization.

In consideration of R. F. C.'s providing said new money by so purchasing said First Mortgage Bonds, Series A, R. F. C.'s existing claim against

the Company, amounting as of January 1, 1939, to \$3,862,870 (\$2,963,000 principal and \$899,870 interest) and represented by notes secured by General and Refunding Mortgage Bonds of the Company and other collateral, shall be provided for under the Plan in like securities and in like proportions as those given holders of the Company's existing First Mortgage Bonds; that is, R. F. C., upon purchasing at par and accrued interest said \$10,000,000 of First Mortgage 4% Bonds, Series A, of the New Company, shall receive Income Mortgage 4½% Bonds, Series A, of the New Company for 40% of the principal of its said claim and 5% Preferred Stock, Series A (\$100 par value) of the New Company for 60% of the principal of its said claim and Common Stock, taken at the price of \$56⅔ per share, for 100% of the interest accrued and unpaid on its said claim. The amounts of securities of the New Company so to be received by R. F. C. are \$1,185,200, principal amount, Income Mortgage 4½% Bonds, Series A, \$1,777,800, par value, 5% Preferred Stock, Series A, and 13,498 shares of Common Stock.

#### IV.

##### Treatment of Existing Securities

1. Existing equipment trusts, Baldwin lease and Pullman contract, aggregating \$2,750,050, shall remain undisturbed and shall be assumed by the New Company.

2. Holders of existing First Mortgage Bonds will receive for each \$1,000 principal amount thereof, together with  $\$266.66\frac{2}{3}$  of interest accrued and unpaid thereon to January 1, 1939:

\$400 Income Mortgage  $4\frac{1}{2}\%$  Bonds, Series A (being 40% of the principal amount of said existing Bonds);

\$600 5% Preferred Stock, Series A (being 60% of the principal amount of said Bonds);

and

4 shares Common Stock (being Common Stock taken at the price of  $\$66\frac{2}{3}$  per share for 100% of said accrued and unpaid interest).

3. R.F.C. will receive in respect of the \$10,000,000 of new money provided for in Article III (or the surrender of Trustees' Certificates at their principal amount and accrued interest, to a like amount) and its existing claim in the principal amount of \$2,963,000, together with \$899,870 of interest accrued and unpaid thereon to January 1, 1939:

\$10,000,000 New First Mortgage 4% Bonds, Series A (being 100% of said new money);

\$1,185,200 Income Mortgage  $4\frac{1}{2}\%$  Bonds, Series A (being 40% of the principal of said claim);

\$1,777,800 5% Preferred Stock, Series A (being 60% of the principal of said claim); and

13,498 shares Common Stock (being Common Stock taken at the price of  $\$66\frac{2}{3}$  per share for 100% of said accrued and unpaid interest).

4. R.C.C. will receive in respect of its claim in the principal amount of \$2,445,610, together with \$146,503 of interest accrued and unpaid thereon to January 1, 1939 (subject to the reduction of said amounts by the Application, prior to the date of issue of the new securities under the Plan, of any proceeds from the distributive shares of the Company or its subsidiaries under the Marshalling and Distributing Plan, 1931):

37,030 shares Common Stock (being Common Stock taken at the price of \$70 per share for 100% of the aggregate amount of said claim).

5. A. C. J. will receive in respect of its claim in the principal amount of \$4,999,800, together with \$1249,950 of interest accrued and unpaid thereon to January 1, 1939:

39,340 shares of Common Stock (being an amount of Common Stock which bears to the amount of Common Stock allotted to the claim of R. C. C., the same proportion that the principal amount of General and Refunding Mortgage Bonds of the Company held by A. C. J. as collateral for said claim, bears to the principal amount of such Bonds held by R. C. C. as collateral for its claim).

6. Neither unsecured creditors nor stockholders shall be entitled to participate in the reorganization.

V  
Distribution of New Securities

Existing Securities	New First Mortgage 4%, Bonds, Series A	New Income Mortgage 4½%, Bonds, Series A	New 5% Preferred Stock, Series A	New Common Stock
5% First Mortgage Bonds		\$19,716,040	\$29,574,100	197,157 shs.
R. F. C.				
New Money	\$10,000,000			
Collateral Note		1,185,200	1,777,800	13,498 shs.
R. C. C. Collateral Note				37,030 shs.
A. C. J. Collateral Note				39,340 shs.
Totals	\$10,000,000	\$20,901,240	\$31,351,900	287,025 shs.



## VI

## Claims Not Affected by the Plan

The following claims are not affected by the Plan: (a) current liabilities of the Company incurred in the ordinary conduct of its business prior to the institution of the Reorganization Proceeding, which are entitled to priority over one or more of the mortgages of the Company, and (b) current liabilities and obligations of the Bankruptcy Trustees incurred during the Reorganization Proceeding.

To the extent that such claims, liabilities or obligations are not paid by the Company or the Bankruptcy Trustees pursuant to order of the Court in the Reorganization Proceeding, they are to be paid in cash or assumed by the New Company. All such claims, liabilities and obligations may be adjusted or compromised and dealt with or paid or discharged by the New Company, all as may be determined by the Board of Directors of the New Company subject to approval by the Court.

The New Company shall be deemed to have assumed such of the contracts of the Company which are executory in whole or in part, including any executory leases and liabilities under guaranties, as shall have been affirmed by the Bankruptcy Trustees in the Reorganization Proceeding with the approval of the Court prior to the date of confirmation of the Plan, and also any executory contracts made by the Bankruptcy Trustees with the approval of the Court in the Reorganization Proceeding.

which, by their terms, do not terminate at the conclusion of the Reorganization Proceeding. [753]

## VII

### Method of Executing the Plan

Existing mortgages on the Company's properties shall be released and cancelled, and all funds on deposit with the Trustees under the Company's mortgages representing sums paid from time to time to such Trustees for the release of properties, sale of scrap, and otherwise, and all collateral pledged under the Company's mortgages, shall be surrendered to the New Company free from liens of the Company's mortgages, after deductions therefrom of any amounts which the Court may find should be deducted under the provisions of such mortgages and consistent with this Plan. All collateral pledged by others than the Company as security for the Company's notes to R. F. C., R. C. C. and A. C. J. shall be surrendered to the pledgors thereof, and all collateral pledged by the Company as security for said notes shall be reduced to possession by the respective pledgees thereof, and shall be by them surrendered to the New Company and cancelled, except that R. C. C. shall not release or surrender any right or interest in the distributive shares of the Company or its subsidiaries under the Marshaling and Distributing Plan, 1931, but any proceeds from such distributive shares after the effective date of the Plan, shall become the property

of and be retained by the R. C. C., but to the extent to which received prior to the issue of the new securities under the Plan shall be applied in reduction of the claim of the R. C. C. in respect of which such new securities are to be issued at the rates provided in Article IV.

The Plan shall be carried out under the supervision of a Reorganization Committee consisting of five persons, three of whom shall be designated by holders of existing First Mortgage Bonds in such manner as the Commission may prescribe, one by R. E. C., and one by R. C. C. and A. C. J. jointly.

The Plan may be carried out either by re-vesting the properties formerly of the Company in the Company or by transferring said properties to a new corporation organized for the purpose, and the execution by the corporation in which said properties are vested of the new mortgages and the issue by it of the new securities contemplated by the Plan.

The method of carrying out the Plan shall be determined by the Reorganization Committee in its discretion, and the Reorganization Committee shall also determine, subject to the approval of the Court, the form, and, except as herein otherwise expressly provided, the provisions, of all mortgages, bonds, coupons, charters, by-laws, stock certificates, voting trust certificates, acceptances, assents, and all other instruments in the judgment of the Reorganization Committee necessary or desirable in connection with carrying out the Plan.

The Reorganization Committee may act by a majority of its members as from time to time constituted, at a meeting or in writing without a meeting. The Reorganization Committee may employ such agents, attorneys and others as it may deem desirable for the purposes of the Plan. The Reorganization Committee may from time to time delegate to others any power or discretion conferred upon it by the Plan; and the members of the Reorganization Committee shall not be liable for any action taken by them in good faith, or by any person employed by the Reorganization Committee in good faith, or otherwise, except for their respective individual malfeasance or wilful neglect.

In case any class of creditors or stockholders shall not accept the Plan in accordance with Section 77, any party may nevertheless move the Court to confirm the Plan on the ground that the interests of such class of creditors have no value, or as the case may be, that the equity of such class of stockholders has no value, or on the ground that the Plan provides for payment in cash to such class of an amount not less than the value of their interests or equity, if any, in accordance with subdivision (c) of Section 77, through the sales hereinafter provided for in accordance with clause (5) of subdivision (b) of Section 77.

If so ordered by the Court, the Plan may be executed by a sale at public auction, at not less than a fair upset price as determined by the Court, of all or any part of the properties and assets of the Com-

pany, free from all liens or claims, other than those herein expressly stated not to be affected by the Plan. Upon any such sale, the properties and assets offered for sale may be purchased for the benefit of the New Company by the Reorganization Committee, or by a purchaser nominated by the Reorganization Committee, and in that event there shall be applied on account of the purchase price the distributive share, if any, of the proceeds of [754] such sale of all securities the holders of which shall have ~~accepted the Plan~~, and the securities, though not accepting the Plan of all classes which, as a class, have accepted the Plan in accordance with Section 77. The Reorganization Committee or its representative may bid, at any such sale, such amounts as the Reorganization Committee may determine.

All properties and assets so sold which are purchased by the Reorganization Committee or its representative shall be transferred to the New Company.

In the event of any such sale, the Reorganization Committee may in its discretion sell all or any portion of the new securities distributable under the Plan in respect of securities of any creditor, if neither such creditor nor the class to which such creditor belongs shall have accepted the Plan in accordance with Section 77. The proceeds of any such sale, together with any other funds which, in the judgment of the Reorganization Committee, are available among the assets of the Debtor Estate or of the New Company may be used to pay the por-

tion of the purchase price payable in cash on any such sale.

Upon any such sale, non-assenting secured creditors of any class which, as a class, shall not have accepted the Plan in accordance with Section 77 and the unsecured creditors and the stockholders of either class shall be entitled to receive, in lieu of the securities, if any, otherwise issuable under the Plan, their aliquot proportion of the proceeds of such sale, after deducting therefrom all expenses of such sale and the amount which would be required to pay in full, of principal and unpaid interest accrued to the date of such sale, all creditors whose claims are prior in lien or superior in equity to the claims of such non-assenting secured creditors or the rights of such unsecured creditors or stockholders.

If any properties and assets are purchased at any such sale by others than the Reorganization Committee or its representative, security holders having an interest in such properties and assets shall be entitled, in accordance with the priorities of their respective interests, to receive, in lieu of the securities, if any, issuable to them hereunder, their aliquot portion of the proceeds of the sale of such property and assets, after deducting therefrom all expenses of such sale. In that event the Reorganization Committee shall, with the approval of the Commission and the Court, make such modifications in the Plan as may be appropriate under the circumstances.

## VIII

## Method of Giving Notice

Unless otherwise provided in Section 77 or any order or orders of the Court in the Reorganization Proceeding or of the Commission, whenever notice shall be required or permitted to be given under or pursuant to the Plan, such notice shall be given by publishing a copy of such notice once in each week on any secular day in each such week for two successive weeks in one newspaper published and of general circulation in the Borough of Manhattan, City and State of New York, and in one newspaper published and of general circulation in the City of San Francisco, State of California, and also (1) in case of notices to security holders who have accepted the Plan, by mailing such notice, postage prepaid, to the addresses of such security holders set forth in the acceptances signed by them; and (2) in case of notices to security holders who shall not have accepted the Plan, by mailing such notice, postage prepaid, to such security holders whose names and addresses appear on the books of the Company or of the New Company, as the case may be, but failure to mail any such notices, or delay in mailing any such notices, shall not invalidate the notice by publication above provided for, which alone shall be sufficient.

## IX

## Expenses of the Reorganization

All expenses in connection with the Plan and its consummation, and all costs of administration and

other allowances made by the Court in the Reorganization Proceeding, shall be paid by the New Company, subject to the provisions of Section 77, and shall constitute a charge upon the properties of the New Company as a cost of administration prior in lien to all new securities issued under the Plan. [755]

There shall be included in such expenses such reasonable compensation for necessary services rendered and reimbursement for actual expenses incurred in connection with the Reorganization Proceeding and the Plan by the Trustees under the mortgages, the Reorganization Committee, the Committee, and other parties in interest and the attorneys or agents of any thereof as may be approved by the Commission and the Court in the Reorganization Proceeding pursuant to Section 77, but no compensation shall be paid to members of the Committee for their services as such members.

## X

### Management

The Board of Directors of the New Company shall consist of not less than seven nor more than eleven members who shall be elected by the holders of the Preferred Stock and the Common Stock of the New Company at an election to be held not later than ninety days after the consummation of the Plan. Pending such election the Board of Directors shall consist of such persons as may be designated by the Reorganization Committee with the approval of the Court.

[Endorsed]: Filed Oct. 5, 1939. [756]

Before the  
Interstate Commerce Commission

Finance Docket No. 10913

In the Matter

of

The Western Pacific Railroad Company  
Reorganization

PETITION OF THE WESTERN PACIFIC  
RAILROAD COMPANY FOR REHEARING  
OF ITS PETITION FOR A MODIFICA-  
TION OF THE REPORT AND ORDER OF  
OCTOBER 10, 1938, AND FOR A MODIFI-  
CATION OF THE COMMISSION'S RE-  
PORT AND ORDER OF JUNE 21, 1939,  
AND FOR THE APPROVAL OF THE AN-  
NEXED PLAN OF REORGANIZATION IN  
SUBSTITUTION FOR THE MODIFIED  
PLAN OF REORGANIZATION PROMUL-  
GATED BY THE COMMISSION. [757]

This Petition of The Western Pacific Railroad Company (herein sometimes called the "Debtor"), filed pursuant to Rule XV of the Rules of Practice of the Interstate Commerce Commission as well as under Subsection (d) of Section 77 of the Bankruptcy Act, respectfully shows:

First: Following the hearing in this proceeding held January 20, 1939, certain parties undertook to negotiate an agreed-upon Plan of Reorganiza-

tion which might be acceptable to the Interstate Commerce Commission and susceptible of early consummation. These negotiations were delicate and protracted but on June 24, 1939, an agreement seemed imminent upon a Plan to be made effective as of January 1, 1939, providing for the following capital structure and allocation of new securities:

[758]



2  
SUMMARY OF CAPITALIZATION OF NEW CORPORATION AND  
ALLOCATIONS OF NEW SECURITIES

Title of Issue	Presently Issued	Interest or Dividends
Undisturbed Equipment Trusts	\$ 2,750,050	\$ 94,202.00
First Mortgage 4% Bonds, Series A, due 1964 (to be taken by Reconstruction Finance Corporation in exchange for \$10,000,000 Trustees' Certificates)	10,000,000	400,000.00
Income Mortgage 4½% Bonds, Series A, due 2014 (to be taken by holders of First Mortgage Bonds and by Reconstruction Finance Corporation for 50% of the principal of their debt)	26,126,550	1,175,694.75
Participating 5% Preferred Stock, Par Value \$100.00 (to be taken by holders of First Mortgage Bonds and by Reconstruction Finance Corporation for 50% of the principal of their debt and by The Railroad Credit Corporation for 100% of the principal of its debt)	28,572,160	1,969,896.75
Total Funded Debt and Preferred Stock	\$67,448,760	
Common Stock (without par value)		520,000 shares
To holders of First Mortgage Bonds	246,450	
Reconstruction Finance Corporation	16,850	
The Railroad Credit Corporation	2,745	
A. C. James Co.	72,350	
The Western Realty Company	365	
The Western Pacific Railroad Corporation as creditor and stockholder	181,240	520,000 shares

[759]

Institutional Bondholders et al.

821

An outline of the foregoing Plan was submitted informally on that date to Division 4 of the Interstate Commerce Commission and request made for a reasonable delay in the pending proceeding to enable the negotiation of a complete agreement upon said Plan by all parties of record to the extent that they might lawfully agree thereon.

Second: Assents to said Plan were given by the following parties by the following described letters upon the terms and conditions and subject to the reservations therein stated:

The Railroad Credit Corporation, by letter addressed by its President, E. C. Buckland, to F. C. Nicodemus, Jr., dated June 28, 1939.

A. C. James Co., by letter addressed by its attorney, Robert E. Coulson, to Hon. Claude R. Porter, Interstate Commerce Commission, dated June 30, 1939.

The Western Pacific Railroad Corporation and The Western Pacific Railroad Company, by letter addressed by its counsel, F. C. Nicodemus, Jr., to Hon. Claude R. Porter, Interstate Commerce Commission, dated June 30, 1939.

Reconstruction Finance Corporation, by letter addressed by its Chairman, Jesse H. Jones, to Hon. Claude R. Porter, Interstate Commerce Commission, dated July 11, 1939.

The original of each of the above letters is in the files of the Interstate Commerce Commission.

The foregoing include all parties of record in this proceeding except (a) the Trustees under the First

Mortgage and the General and Refunding Mortgage of The [769] Western Pacific Railroad Company who are not authorized to represent holders of Bonds under such Mortgage for the purpose of accepting or rejecting any plan of reorganization, and (b) Frederick H. Ecker, John W. Stedman and Reeve Schley, as a Committee representing certain institutional holders of First Mortgage Bonds of The Western Pacific Railroad Company under a group agreement dated as of September 1, 1936, who asked for certain modifications of the Plan as the condition of their acceptance thereof or acquiescence therein.

Third: On July 24, 1939, ~~the respective counsel for the above named Committee, for the A. C. James Co. and for The Western Pacific Railroad Corporation and The Western Pacific Railroad Company, agreed upon the modifications of the Plan asked by said Committee and on July 25, 1939, were in process of securing the approval thereof by their respective clients to the extent that they were authorized to approve the same when the Interstate Commerce Commission released its Report and Order dated June 21, 1939, modifying the Plan of Reorganization promulgated in its Report and Order dated October 10, 1938.~~ The Plan so approved by counsel for the said Committee, for the A. C. James Co. and for The Western Pacific Railroad Corporation and The Western Pacific Railroad Company, differs from the earlier Plan referred to in paragraph First hereof slightly in mat-

ters of detail and in the following matters of substance:

(a) The maturity date of the new First Mortgage Bonds is changed from the year 1964 to the year 1989.

(b) The number of shares of Common Stock (without par value) is increased from 520,000 to 525,300 shares, which are allocated as follows: [761]

To holders of First Mortgage Bonds	262,875
To Reconstruction Finance Corporation	17,995
To Railroad Credit Corporation	2,930
To A. C. James Co.	72,350
To The Western Realty Company	365
To The Western Pacific Railroad Corporation, as creditor and stockholder	168,785

(c) The provision for the creation of a Reorganization Committee was recast so as to read: "The Plan shall be carried out under the supervision of a Reorganization Committee consisting of five persons, three to be selected by vote of the First Mortgage Bondholders in such manner as the Commission shall direct, one by R. F. C. (meaning Reconstruction Finance Corporation) and one by A. C. J. (meaning A. C. James Co.)"

A copy of the final proof of the Plan is hereto annexed as Exhibit A.

Fourth: Your petitioner avers that notwithstanding the release by the Interstate Commerce Commission on July 25, 1939, of its Report and Order dated June 21, 1939, modifying the Plan promulgated under its Report and Order dated October 10, 1938, the parties in interest may desire the Commission to certify to the Court in substitution for its modified Plan the Plan set forth in Exhibit A hereto (herein and in the annexed brief sometimes called the "agreed-upon Plan") for the following reasons:

(a) The agreed-upon Plan is susceptible of early consummation whereas the Commission's modified Plan could be made effective if at all only at the end of litigation which is almost certain to be protracted.

(b) Under the agreed-upon Plan, the existing First Mortgage Bonds in consideration of [762] concessions made to the junior creditors and stockholders secure the relinquishment of the following lien claims, among others, asserted by the Trustee of the General and Refunding Mortgage of the Railroad Company:

1. A first and paramount lien on an undivided half interest in the Northern California Extension representing a total investment of not less than \$10,000,000.

2. A first and paramount lien upon the equity in equipment having a depreciated book value as of December 31, 1935, of \$6,169,121.48.

Under the modified Plan of the Interstate Commerce Commission, holders of First Mortgage Bonds will receive 230,593 shares of Common Stock out of a total issue of 319,441 shares or 72.189% thereof whereas under the agreed-upon Plan they will receive 262,875 shares out of a total issue of 525,300 shares or 50.042% thereof. They also concede a preferred stock position to Railroad Credit Corporation for the principal of its debt. By making this concession to Railroad Credit Corporation and agreeing to an increase in the number of shares of Common Stock by the amount of 205,859 shares of which increased number of shares they themselves are allotted 32,282 shares—a net dilution as against the holders of First Mortgage Bonds of 173,577 shares—holders of First Mortgage Bonds avoid litigation and the delays and expense incident thereto and secure the complete relinquishment of the substantial lien claims specified above. Although these lien claims are resisted by the Trustees of the First Mortgage and by the Committee representing the institutional group of First Mortgage Bondholders, and although the Interstate Commerce Commission has determined these lien issues in favor of the First Mortgage and against the General and Refunding Mortgage, it [763] is obvious that the claims are substantial and of such character that they must be determined by a Court of last resort before it will be practicable either under the machinery provided by Section 77 of the Bank-

ruptcy Act or by equity foreclosure to make effective any Plan other than an agreed-upon Plan.

Fifth: The Board of Directors of The Western Pacific Railroad Corporation will recommend to its stockholders approval of the agreed-upon Plan in the form annexed hereto as Exhibit A and upon such acceptance by its stockholders, The Western Pacific Railroad Corporation and The Western Pacific Railroad Company will cooperate in every possible way to facilitate its early consummation.

Wherefore, your petitioner prays the Commission for a rehearing of its petition for a modification of the Report and Order of October 10, 1938, and for a modification of the Commission's Report and Order of June 21, 1939, and for the approval of the annexed Plan of Reorganization in substitution for the modified Plan of Reorganization promulgated by the Commission.

Answers to this Petition are required within ten days under Rule XV(b) of the Interstate Commerce Commission.

Respectfully submitted,

FRANK C. NICODEMUS, JR.,

Counsel, The Western Pacific Railroad Company,  
40 Wall Street, New York City.

Dated, August 1, 1939. [764]

State of New York,

County of New York—ss.

Michael J. Curry, being duly sworn, deposes and says: That he is Vice-President of the above named petitioner, The Western Pacific Railroad Company; that he has read the foregoing petition and knows the contents thereof and verily believes it to be true in all respects.

MICHAEL J. CURRY.

Subscribed and sworn to before me this 1st day of August, 1939.

(Seal)

HOWARD A. FISCHER,

Notary Public, Kings Co. No. 123, Reg. No. 230.

Cert. filed in N. Y. Co. No. 306, Reg. No. O-F-187.

Commission expires March 30, 1940. [765]

Before the  
Interstate Commerce Commission

Finance Docket No. 10913

In the Matter of THE WESTERN PACIFIC  
RAILROAD COMPANY REORGANIZA-  
TION

---

BRIEF IN SUPPORT OF THE FOREGOING  
PETITION.

On August 2, 1935, four years ago tomorrow, The Western Pacific Railroad Company filed its petition for reorganization under Section 77 of the Bankruptcy Act. During the four years that have since elapsed, the property has been rehabilitated at a cost of \$10,000,000 and is now an up-to-date property ripe for immediate reorganization.

On July 24, 1939, all parties of record or their counsel, as the result of negotiations which have been practically continuous since the final argument in this proceeding on [756] January 20, 1939, had agreed upon a Plan of Reorganization, a proof of which is annexed as Exhibit A to the foregoing petition.

On July 25, 1939, while counsel were in process of securing for filing with the Interstate Commerce Commission formal assents of their clients to the agreed-upon Plan, the Interstate Commerce Commission released its Report and Order dated June 21, 1939, which modified in detail but not in prin-

ciple the Plan of Reorganization promulgated by the Commission under its Report and Order of October 10, 1938.

No provision is made for the unsecured creditors and stockholders of the Railroad Company whose investment is threatened, with extinction.

The Western Pacific Railroad Company, in order to make possible an early reorganization giving recognition to the investment of its junior creditors and stockholders and to avert unnecessary and wasteful litigation injurious to its property as well as to the entire railway industry, now asks that the Commission substitute the agreed-upon Plan for its own modified Plan and certify the agreed-upon Plan for the approval of the Court.

For convenience of comparison, the agreed-upon Plan and the Commission's modified Plan are set out in parallel columns: [767]



Title of Issue	Agreed-Upon Plan		Commission's Modified Plan	
	Effective date		Effective date	
	January 1, 1939		January 1, 1939	
	Capital Issue	Interest, dividend or other charge	Capital Issue	Interest, dividend or other charge
Undisturbed Equipment Trusts, Baldwin Lease and Pullman Contract.....	\$ 2,750,050	\$ 94,202.00	\$ 2,750,050	\$ 94,202.00
First Mortgage Bonds, Series A.....	10,000,000	400,000.00	10,000,000	400,000.00
Total Annual Fixed Charges.....		494,202.00		494,202.00
		300,000.00		500,000.00
Income Mortgage 4½% Bonds, Series A.....	26,126,550	1,175,694.75	21,219,075	954,858.00
Total Funded Debt.....	\$38,876,600		\$33,969,125	
Total Annual Charges (fixed and contingent) and Capital Fund.....		1,969,896.75		949,060.00
Income Mortgage Sinking Fund.....		130,632.55		106,095.00
Participating Preferred Stock, 5% Series (par value \$100).....	28,572,160	1,428,608.00	31,850,297	1,592,515.00
Total of Funded Debt and Preferred Stock.....	\$67,448,760		\$65,819,422	
Total Annual Charges, Capital Fund, Sink- ing Fund and Preferred Dividend require- ments.....		3,529,137.50		3,647,670.00
Common Stock (without par value).....	525,300 Shares		319,141 shares	

*Institutional Bondholders et al.*

Under the agreed-upon Plan, the maturity of the new First Mortgage Bonds is 1989 whereas under the Commission's modified Plan the maturity date is 1964 and the Capital Fund is mandatory at \$300,000 and permissive up to \$500,000, whereas under the Commission's modified Plan the Capital Fund is mandatory at \$500,000. The allotments of no par value Common Stock under the respective Plans are set out below.

Allottees of Common Stock	Agreed-Upon Plan	Commission's Plan
Holders of First Mortgage Bonds	262,875	230,593
Reconstruction Finance Corporation	17,995	15,788
The Railroad Credit Corporation	2,930	35,425
A. C. James Co.	72,350	37,635
The Western Pacific Railroad Corporation, as creditor	44,850	
The Western Pacific Railroad Corporation, as stockholder	123,935	
Western Realty Company	365	
Totals	525,300 shares	319,441 shares

[768]

For purposes of this brief we assume that all parties of record (except the mortgage Trustees who are not permitted either to accept or reject a Plan of Reorganization on behalf of their cestui que trust Bondholders) will in their answers to our petition reaffirm their adhesion to the agreed-upon Plan.

We also assume that the Interstate Commerce Commission will not hesitate to substitute the

agreed-upon Plan for its own modified Plan if convinced—

(a) that the agreed-upon Plan is compatible with the public interest;

(b) that the assents of record are sufficient to give reasonable assurance of acceptance of the Plan by the requisite percentages of the several classes of creditors and security holders;

(c) that the agreed-upon Plan is not unfair to any party in interest not represented by the parties of record who have assented to the Plan.

We shall briefly discuss these propositions in their order as stated.

(a) The agreed-upon Plan is compatible with the public interest.

The agreed-upon Plan differs from the Commission's modified Plan in only two aspects that could have any relation to the public interest—

(1) the allotment of Income Mortgage 4½% Bonds to holders of First Mortgage Bonds and to Reconstruction Finance Corporation for the principal of their debt is increased from 40% to 50% and the allotment of Preferred Stock is correspondingly decreased;

(2) the number of shares of Common Stock without par value is increased from 319,441 shares to 525,300 shares. [769]

Otherwise the capital structures under the two Plans are almost identical.

The increase of the allotment of Income Mortgage 4½% Bonds from 40% to 50% may be passed over without argument, because (1) a better balanced capital structure results; (2) better treatment is given to holders of First Mortgage Bonds and to Reconstruction Finance Corporation and (3) the allotment of equal amounts of Income Bonds and preferred stock for the principal of senior debt conforms to the Plan recently approved by both the Commission and the Court for the Chicago and Eastern Illinois Railway Company.

The increase in the number of shares of Common Stock (without par value) from 319,441 shares to 525,300 shares cannot be deemed to affect adversely the public interest.

The Commission's modified Plan provides for a capitalization of \$97,763,522 calculating 319,441 shares of common stock without par value at \$100. per share. As we understand it this capitalization reflects the amount of capital upon which the Commission estimates the future earnings may yield a return.

The agreed-upon Plan provides for a capitalization of \$67,448,760 exclusive of 525,300 shares of common stock without par value to which no value is assigned but which if calculated at \$50 per share will produce a capitalization *below* that provided for in the Commission's modified Plan.

But it is neither necessary nor desirable to complicate our reorganization problem by attempting at this time to fix any stated value for the no-par value common stock. [770]

This question should be determined *after* reorganization and following a hearing to determine the composition of the initial balance sheet of the reorganized company in respect of which the Commission will retain all jurisdiction that it now has to prescribe a book value for such no par value stock predicated upon its estimate of the probable future earning power of the property. (*Atlanta, Birmingham and Coast Railroad Company v. United States*, 296 U. S. 33 (1935).)

- (b) The assents of record are sufficient to give reasonable assurance of acceptance of the Plan by the requisite percentages of the several classes of creditors and security holders.

Each of the three secured creditors, i. e., Reconstruction Finance Corporation, The Railroad Credit Corporation and the A. C. James Co. is a corporation qualified to accept a Plan either under or in advance of formal submission in accordance with Section 77 of the Bankruptcy Act. Apart from these three secured creditors and the mortgage trustees who are sterilized by Section 77 the only parties in interest are (a) holders of First Mortgage Bonds and (b) The Western Pacific Railroad Corporation; as an unsecured creditor and the sole stockholder of The Western Pacific Railroad Company.

As explained at the oral argument on January 20, 1939, the acceptance of the Plan by The Western Pacific Railroad Corporation must be made subject to the subsequent approval of the stockholders of The Western Pacific Railroad Corporation; but the concentration of large amounts of this stock in the ownership of interests identified with the present management of the Railroad Company reasonably assures the prompt acceptance of the Plan by such stockholders. [771]

Approximately one-third of the outstanding First Mortgage Bonds are represented by the Committee for institutional holders of First Mortgage Bonds. Substantial additional amounts of First Mortgage Bonds are owned by The Western Pacific Railroad Corporation and are pledged to the Curtiss Southwestern Company and Central Hanover Bank and Trust Company and further amounts are held by interests closely identified with the management. With these large blocks of First Mortgage Bonds supporting the agreed-upon Plan, it is reasonable to anticipate almost unanimous support of other holders of First Mortgage Bonds. If the Plan is approved by the Commission and the Court, assents on behalf of the requisite percentage of First Mortgage Bonds seem a foregone conclusion.

- (c) The agreed-upon Plan is not unfair to any party in interest not represented by the parties of record who have assented to the Plan.

It has been suggested that the Interstate Commerce Commission should hesitate to approve the

agreed-upon Plan, unless and until satisfied that it is fair and equitable to holders of First Mortgage Bonds, approximately two-thirds of which are not represented of record by the Committee.

Apart from the increase in the allotment to holders of First Mortgage Bonds of 50% of the principal thereof in Income Mortgage  $4\frac{1}{2}\%$  Bonds instead of 40% as provided in the Commission's modified Plan and the use of preferred stock in adjusting the principal debt held by Railroad Credit Corporation, the only substantial change affecting holders of First Mortgage Bonds is in the increase of the number of shares of Common [772] Stock without par value from 319,441 shares to 525,300 shares and a reallocation of certain of the additional shares among the junior creditors and stockholders of the Railroad Company. This increase and reallocation of the Common Stock reduces the percentage of the entire issue allocated to First Mortgage Bonds from 72.189% to 50.042%.

For this concession to Railroad Credit Corporation and the relinquishment of 22.147% of the equity to the junior interests, holders of First Mortgage Bonds receive the following considerations, among others:

(a) assurance of an early, economical reorganization;

(b) avoidance of litigation which the Commission's modified Plan forces upon the junior interests whose equity of approximately \$25,

500,000 based upon the Commission's own 19-A Valuation is to be taken from them and transferred to senior creditors, largely to holders of First Mortgage Bonds;

(c) relinquishment of the lien claims of the secured creditors of the Railroad Company asserted by the Trustee under the General and Refunding Mortgage (1) to an undivided half interest in the Northern California Extension and (2) to the equity in equipment having depreciated book value as of December 31, 1935, of \$6,169,121.48.

Any one of items (a), (b) and (c) is alone an adequate consideration for the concession to Railroad Credit Corporation and the relinquishment by holders of First Mortgage Bonds to the junior interests of 22.147% of the equity (which the Commission seems to regard as a remote equity) represented by the common stock of the reorganized company. It would unduly extend this brief to [773] discuss these items in detail or to emphasize the many points of resistance to the Commission's modified Plan which we think inevitable if it is certified to the Court.

A brief exposition of the lien claim asserted by the General and Refunding mortgage against the new north and south line known as the Northern California Extension will be sufficiently illustrative.

3

By the terms of the First Mortgage, the lien thereof extends to any newly acquired railway or extension constructed or acquired by the use of First Mortgage Bonds or their proceeds but does not attach to such railway or extension if financed independently of the First Mortgage.

The Northern California Extension was constructed at an approximate cost of \$10,000,000 of which one-half was provided through the sale of First Mortgage Bonds and one-half by junior interests (who ultimately became pledgees of General and Refunding Mortgage Bonds), the project having cost double the amount of the original estimate.

If the extension had been constructed in two sections, one section financed through the First Mortgage, the other section through resources independent of the First Mortgage, there would be no lien controversy—the First Mortgage and the General and Refunding Mortgage each would have an uncontested lien on approximately one-half of the entire mileage.

The construction did not, however, take that form. Rights of way for practically the entire mileage were acquired at the outset and cash provided by sale of First Mortgage was expended indiscriminately over the whole project.

Upon this state of facts the trustees of the First Mortgage assert with apparent confidence a first and paramount lien on the entire Extension while the trustees of [774] the General and Refunding

Mortgage with equal confidence asserts a lien on an undivided half interest—a lien proportionate to capital which the junior interests put into the enterprise.

“Equity regards substance rather than form”—is one of the most favored maxims of the Equity Courts.

Looking only to substance and disregarding form as equity is wont to do no one can well question that *only* one-half of the Northern California Extension was constructed through funds provided under the First Mortgage.

It is not our purpose to suggest what is the correct determination of this lien question but merely to make clear that it contains the germ of a major lawsuit the outcome of which no one can possibly predict. Should a Chancellor (as he might readily do) accord to the General and Refunding Mortgage a lien upon an undivided half interest in this important property the result would probably be fatal to the Commission's modified Plan. It would be necessary to start de novo and to develop a basically different Plan—in all probability one involving partial if not complete liquidation of the junior secured debt collateralized by bonds issued under the General and Refunding Mortgage.

Settlement of this and other controversial issues is not only an adequate consideration for the recession to junior interests of the 22.147% of their own equity and the other concessions provided for in

the agreed-upon Plan but is a splendid result for the holders of First Mortgage Bonds.

It must be borne in mind that even after ceding 22.147% of the equity back to the junior creditors and stockholders of the Railroad Company the holders of the First Mortgage Bonds will still retain two shares of the [775] common stock of the reorganized company for each \$100 of unpaid interest.

That so many railway properties remain in trusteeship or receivership is one of the criticisms of the railway industry to which there has been no answer. The reaction to that condition made possible the passage by the United States Senate of the coercive measure known as the Wheeler Bill. The progress of this legislation has been halted in the House. The strongest argument for its ultimate defeat would be one sound reorganization under the existing statute brought about through the co-operative effort of the railway industry and the Interstate Commerce Commission.

The Western Pacific security holders or their counsel have done their part. They have agreed upon a fair and equitable Plan that recognizes every interest in the property and forecloses no interest. They have done what the Chandler Act, the latest declaration of Congressional policy says they should do; they have themselves agreed upon a Plan.

Acceptance of this Plan by the Interstate Commerce Commission as a modification of its own

Plan would be a constructive act making possible a sound reorganization and a discharge of the property from the Court not later than December 1, 1939—the maturity date of \$10,000,000 of Trustees' Certificate's.

Respectfully submitted,

FRANK C. NICODEMUS, JR.,

Counsel, The Western Pacific  
Railroad Company,

40 Wall Street,  
New York City.

Dated, August 1, 1939. [776]

#### CERTIFICATE OF SERVICE.

I hereby certify that on August 1, 1939, I served the foregoing document on all parties of record by mailing or delivering a true copy thereof to each of said parties.

FRANK C. NICODEMUS, JR.

[777]

EXHIBIT A

The Western Pacific Railroad Company

PLAN OF REORGANIZATION

Effective Date, January 1, 1939

[778]

List of Certain Abbreviated Terms

A. C. J.—A. C. James Company.

Committee.—The Committee representing certain institutional holders of First Mortgage Bonds of the Company, acting under a group agreement dated as of September 1, 1936, and consisting of Frederick H. Ecker, Chairman, John W. Stedman and Reeve Schley.

Bankruptcy Trustees.—The Trustees now or hereafter operating the properties of The Western Pacific Railroad Company by appointment of the Court in the Reorganization Proceeding.

Commission.—The Interstate Commerce Commission.

Company or Debtor.—The Western Pacific Railroad Company.

Consummation of the Plan.—The transfer to the New Company, to the extent contemplated by the Plan, of the properties and assets of the Company.

Court.—The District Court of the United States for the Northern District of California, Southern Division.

**Effective Date of the Plan.**—The date from which interest shall run on the new securities provided in the Plan, namely, January 1, 1933.

**Existing First Mortgage Bonds.**—Bonds issued under the First Mortgage dated June 26, 1916, from the Company to First Federal Trust Company and Henry E. Cooper, as Trustees (Crocker First National Bank and Samuel S. Armstrong, Successor Trustees) designated as the First Mortgage.

**General and Refunding Bonds.**—Bonds issued under the Mortgage dated January 1, 1932, from the Company to The Chase National Bank of the City of New York as Trustee (Irving Trust Company now Successor Trustee), designated as the General and Refunding Mortgage.

**New Company.**—The corporation, whether the Company or a new corporation, which shall acquire the greater part of the properties now held by the Bankruptcy Trustees and issue the new securities provided for by the Plan.

**Plan.**—This proposed plan of reorganization.

**Reorganization Committee.**—The Reorganization Committee appointed as herein provided.

**R. C. C.**—The Railroad Credit Corporation.

**R. F. C.**—Reconstruction Finance Corporation.

**Reorganization Proceeding.**—The pending proceeding under Section 77 of the Bankruptcy Act, as amended, before the Court involving the properties of the Company (Docket No. 7,004), includ-

ing also (unless the context otherwise indicates) the related proceeding before the Commission (Finance Docket No. 10,008).

W. P. Corp.—The Western Pacific Railroad Corporation, sole stockholder of the Company. [779]

I

Present Capital Liabilities as of January 1, 1939  
(including unpaid interest)

		Fixed Annual* Interest
Equipment Trusts, Baldwin Lease and Pullman Contract	\$ 2,750,050	\$ 94,202
First Mortgage 5% Bonds due 1946:		
Principal	\$49,290,400	2,464,505
Unpaid Interest	13,143,777	
Total	62,433,877	
Notes to R. F. C. (secured by pledge of \$10,750,000 General and Refund- ing Bonds; also by a second lien upon \$2,000,000 General and Refund- ing Bonds pledged to secure Note to R. C. C.):		
Principal	\$ 2,963,000	177,780
Unpaid Interest	899,870	
Total	3,862,870	
Note to R. C. C. (Secured by pledge of \$4,000,000 General and Refund- ing Bonds; also by a second lien upon \$10,750,000 General and Refund- ing Bonds pledged to secure the Note to R. F. C.; also by a first lien upon the rights of the Company under the Marshalling and Distribut- ing Plan of 1931):		
Principal	\$ 2,445,610	24,456
Unpaid Interest	146,503	
Total	2,592,113	
Note to A. C. J. (Secured by pledge of \$1,249,500 of General and Refund- ing Bonds. \$2,000,000 of the General and Refunding Bonds pledged to secure the Note to R. C. C. were initially pledged to secure the Note to A. C. J. and by it repledged as additional collateral with the R. C. C.)		
Principal	\$ 4,999,800	249,990
Unpaid Interest	1,249,950	
Total	6,249,750	
Unsecured Obligations to W. P. Corp.**		
Principal	\$ 5,817,543	
Unpaid Interest	1,992,096	
Total	7,809,639	290,877
Preferred Stock	28,300,000	

**Present Capital Liabilities as of January 1, 1939**  
(including unpaid interest)

		Fixed Annual Interest
Equipment Trusts, Baldwin Lease and Pullman Contract	\$ 2,750,050	\$ 94,202
First Mortgage 5% Bonds due 1946:		
Principal	\$49,290,100	2,464,505
Unpaid Interest	13,143,777	
Total	62,433,877	
Notes to R. F. C. (secured by pledge of \$10,750,000 General and Refund- ing Bonds; also by a second lien upon \$2,000,000 General and Refund- ing Bonds pledged to secure Note to R. C. C.):		
Principal	\$ 2,963,000	177,780
Unpaid Interest	899,870	
Total	3,862,870	
Note to R. C. C. (Secured by pledge of \$4,000,000 General and Refund- ing Bonds; also by a second lien upon \$10,750,000 General and Refund- ing Bonds pledged to secure the Note to R. F. C.; also by a first lien upon the rights of the Company under the Marshalling and Distribut- ing Plan of 1931):		
Principal	\$ 2,445,610	24,456
Unpaid Interest	146,503	
Total	2,592,113	
Note to A. C. J. (Secured by pledge of \$4,249,500 of General and Refund- ing Bonds. \$2,000,000 of the General and Refunding Bonds pledged to secure the Note to R. C. C. were initially pledged to secure the Note to A. C. J. and by it repledged as additional collateral with the R. C. C.)		
Principal	\$ 4,999,800	249,990
Unpaid Interest	1,249,950	
Total	6,249,750	
Unsecured Obligations to W. P. Corp.**		
Principal	\$ 5,817,543	
Unpaid Interest	1,992,096	
Total	7,809,639	290,877
Preferred Stock	28,300,000	
Common Stock	47,500,000	
	\$161,498,299	\$3,301,810*

\*Without interest on interest accrued and unpaid on First Mortgage Bonds, on R. F. C., R. C. C. or A. C. J. Notes or on W. P. Corp. Advances; and computing interest on the R. C. C. Note at 1%, the New York Federal Reserve Bank discount rate as of November 1, 1938.

\*\*Includes advances from Western Realty Company—\$50,000 principal; \$11,667 interest.

## II.

### Proposed Capitalization of the New Company

#### 1. Summary

The capitalization proposed herein for the New Company is substantially as follows:

Title of Issue	Presently Issued	Interest or Dividends
Undisturbed Equipment Trusts, Baldwin Lease and Pullman Contract	\$ 2,750,050	\$ 94,202.00
First Mortgage 4% Bonds, Series A, due 1939	10,000,000	400,000.00
Total Annual Fixed Charges		494,202.00
Capital Fund		300,000.00
Income Mortgage 4½% Bonds, Series A, due 2014	26,126,550	1,175,694.75
Total Funded Debt	\$38,876,600	
Total Annual Charges (fixed and contingent) and Capital Fund		1,969,896.75
Income Mortgage Sinking Fund		130,632.75
Participating Preferred Stock, 5% Series (par value \$100)	28,572,160	1,428,608.00
Total of Funded Debt and Preferred Stock	\$67,448,760	
Total Annual Charges, Capital Fund, Sinking Fund and Preferred Dividend Requirements		3,529,137.50
Common Stock (without par value)	525,300 shs.	

Institutional Bondholders et al.

## 2. First Mortgage Bonds

## A. Lien of Mortgage.

The First Mortgage will be a lien, directly or through pledge of securities, subject only to liens upon equipment, on all the properties and assets owned by the New Company on the consummation of the Plan, including securities, equipment, and the equity in such equipment as is subject to equipment obligations. The First Mortgage will also be a lien on all similar property acquired by the New Company after the reorganization, except that (a) if the New Company shall acquire the properties of any other company (except a company which is a wholly owned railway subsidiary on January 1, 1939), constituting a Class I carrier as defined by the rules then in force of the Interstate Commerce Commission or other public regulatory bodies having jurisdiction at the time, such properties shall not be subject to the lien of the First Mortgage unless acquired in whole or in part by the use of First Mortgage Bonds or Income Mortgage Bonds, or moneys deposited under the First Mortgage or the Income Mortgage, and (b) if the New Company shall be consolidated with, or shall be merged into, or shall sell its assets substantially as an entirety to, any other company which at the time is a Class I carrier as defined as aforesaid, no properties theretofore owned or thereafter acquired by such other company shall be subject to the lien of the First Mortgage except properties thereafter acquired

which shall be appurtenant or incident to properties subject to the lien of the First Mortgage, or which shall be within the maintenance or replacement covenants of the First Mortgage, or which shall be acquired in whole or in part by the use of First Mortgage Bonds or Income Mortgage Bonds or moneys deposited under the First Mortgage or the Income Mortgage.

**B. Issue Limited—Sinking Fund. if Certain Limits Exceeded.**

The amount of bonds at any time outstanding under the First Mortgage will be limited to \$50,000,000.

The First Mortgage will provide (1) that on each May 1 when the aggregate principal amount of First Mortgage Bonds outstanding shall equal or exceed \$20,000,000, the New Company will pay to the Trustee under the First Mortgage as a Sinking Fund a sum equal to  $\frac{1}{2}$  of 1% of the maximum principal amount of First Mortgage Bonds theretofore at any one time authenticated and uncanceled; and (2) that on each May 1 when the aggregate principal amount of First Mortgage Bonds outstanding plus all other funded debt bearing fixed interest shall exceed either (a) 35% of the total capitalization of the New Company, deter- [781] mined as hereinafter provided, or (b) 50% of such total capitalization, less the principal amount of funded debt bearing contingent interest at the time outstanding, the New Company, in addition to the

sums provided in Clause (1) of this Subdivision B to be paid, will pay into said Sinking Fund a sum equal to 50% of the Available Net Income of the next preceding calendar year that remains after providing for all Income Mortgage sinking funds and charges prior thereto (i.e., that remains after the deductions made pursuant to paragraphs (1), (2), (3), (4) and (5) of Subdivision G of Section 3 of this Article II; or after the provisions of said Subdivision G shall have ceased to be operative, 50% of net income as defined by the accounting rules or practice referred to in said Subdivision G). Such Sinking Fund shall be applied to the retirement of First Mortgage Bonds, by purchase in the open market or by call for tenders at not exceeding the redemption price (or in the case of bonds not redeemable, the principal amount and accrued interest), and whenever the amount in the Sinking Fund exceeds \$50,000 and First Mortgage Bonds are not tendered or cannot otherwise be purchased at less than their redemption price, the funds then in the Sinking Fund shall be applied to the redemption of First Mortgage Bonds on the next succeeding interest payment date. All bonds so acquired shall be cancelled and no bonds may be issued to refund any such bonds. First Mortgage Bonds and Income Mortgage Bonds outstanding shall be deemed to include all bonds authenticated and delivered to the New Company which shall not have been cancelled or assured of retirement through the deposit of cash. Funded debt shall include an amount equal to the

capitalized value, at 5% per annum, of fixed rents payable for leased road, other than terminal or bridge properties, but shall not include (a) obligations (other than mortgage bonds or equipment trust obligations) maturing not more than two years after their date, or (b) obligations of longer maturity secured by pledge of bonds having a lien on property of the New Company except to the extent, if any, by which the principal amount of such obligations exceeds the principal amount of such bonds so pledged. Bonds guaranteed by the New Company as to interest or principal or both (other than bonds of a terminal or bridge company) shall be included in funded debt, but, in case of a joint and several guaranty with other corporations, only to the extent of the New Company's basic proportion of the principal liability. There shall be included in determining total capitalization only (a) obligations constituting funded debt, (b) stock having par value, at such par value, and (c) stock without par value, at \$100 a share in case of the stock issuable under the Plan, and, in case of other stock, at the capital value at which such stock is carried on the books of the Company, not exceeding, however (except to the extent that earned surplus shall have been duly capitalized), the net amount received by the New Company on the issue thereof.

### C. Issue in Series.

The First Mortgage Bonds may be issued from time to time in different series, subject to such limitations and restrictions as may be specified in the

First Mortgage, payable on such date or dates, in such denominations, bearing interest at such rates and containing such provisions in regard to redemption, conversion, taxes, place or places and money or moneys of payment, registration and sinking funds and having such other characteristics as may be prescribed by the Board of Directors of the New Company at the time of issue, but with respect to the lien of the First Mortgage all equally secured.

**D. Bonds of Series A to be Issued in Reorganization.**

\$10,000,000 First Mortgage Bonds, Series A, are to be authenticated and issued in the reorganization for the purpose of providing the \$10,000,000 of new money required in the reorganization.\*

The Bonds of Series A shall be dated January 1, 1939, shall bear interest at the rate of 4% per annum, payable semi-annually, and shall be redeemable, in whole or in part, at any time upon thirty days' notice, at their principal amount and accrued interest, plus a premium of 1/10th of 1% of their principal amount for each six months, or fraction thereof, from the date of redemption to the date then fixed for their maturity as hereinafter provided. The Bonds of Series A shall mature January 1, 1989, provided, however, that if while any Bonds of Series A shall be outstanding additional Bonds shall be issued under the First Mortgage having a

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\*See Article III below.

fixed maturity earlier than January 1, 1989, then the Bonds of Series A shall mature on the earliest date at which any such additional Bonds so issued shall mature. [782]

E. Issue of Additional First Mortgage Bonds.

First Mortgage Bonds, in addition to those to be authenticated in the reorganization, may be authenticated from time to time: (a) to refund First Mortgage Bonds (excluding bonds issued solely by way of pledge, except as hereinafter provided) or outstanding obligations secured by First Mortgage Bonds to the extent so secured or obligations secured by prior lien on after acquired property; or (b) upon the deposit of new cash equal to the principal amount to be issued; or (c) to provide for, or to reimburse the New Company for, not exceeding 75% of expenditures made after December 31, 1938, but not more than three years prior to the date of such authentication (including expenditures for the acquisition or construction of new railroad equipment, free from lien, but not including expenditures for the making of additions and betterments to equipment) which, under the accounting rules of the Interstate Commerce Commission or other federal regulatory bodies having jurisdiction in the premises, at the time in force, are properly chargeable to capital account; provided, however, that

(a) Except when bonds are authenticated in respect of new mileage (or securities representative thereof) or in respect of new equipment the said 75% shall be applied to the net amount of said capi-

tal expenditures after deducting therefrom, to such extent and on such basis as may be specified in the First Mortgage, credits to capital account after December 31, 1938;

(b) If any First Mortgage Bonds are authenticated or cash deposited under the First Mortgage is withdrawn to provide or reimburse for the acquisition of railroad equipment, a sinking fund shall be established (in addition to any other sinking fund then in effect for any series of First Mortgage Bonds) payable in equal annual instalments in an amount sufficient to retire (at par) within the expected efficient service life of such equipment (in no case to exceed fifteen years) a principal amount of First Mortgage Bonds equal to (1) the principal amount of bonds so authenticated or (2) the amount of deposited cash so paid;

(c) If any property is acquired subject to existing liens the amount of additional First Mortgage Bonds issuable therefor or issued to refund prior lien obligations thereon, together with the aggregate amount of existing liens to which such property is subject, shall not exceed 75% of the net cost thereof, including as part of such cost the amount of such existing liens whether or not the indebtedness secured thereby is assumed by the New Company; and

(d) No bonds shall be issued on the basis of the acquisition of equipment under equipment trust obligations or any obligations for the deferred or serial payment of the purchase price for equipment;

or on the basis of the retirement of any such obligations.

**F. Restrictions Designed to Limit Future Financing through First Mortgage Bonds and Restrictions on Pledges.**

The First Mortgage will contain a covenant substantially to the effect that no First Mortgage Bonds (other than those to be authenticated under the Plan) will be sold or pledged unless (1) the New Company shall have contracted forthwith to sell or pledge such bonds and (2) the Board of Directors of the New Company, by resolution adopted by two-thirds of the entire number of directors, shall have determined that, in the opinion of the Board, taking into account market and all other relevant conditions at the time, it is impracticable to provide the amount of money needed (a) by the sale of Income Mortgage Bonds having a maturity of twenty years or more at a price which would give a yield to maturity of 5% or less, or (b) by the sale of Preferred Stock at a price which would give a current dividend return of 6% or less, or (c) by the sale of Common Stock at a price (not less than \$50 per share) which would give a current dividend return (based on the regular dividend rate then in effect, or, if no regular dividend rate is in effect, on the average rate at which dividends shall have been paid during the last twelve calendar months) of 6% or less.

The First Mortgage will also contain a covenant substantially to the effect that the excess of the aggregate principal amount of all First Mortgage Bonds under pledge at any one time over the principal amount of all indebtedness so secured shall not exceed 10% of the aggregate principal amount of all First Mortgage Bonds then authenticated and uncanceled. [783]

### 3. Income Mortgage Bonds

#### A. Lien of Mortgage.

The Income Mortgage shall constitute a lien, subject to the lien of the First Mortgage, upon all property from time to time subject to the lien of the First Mortgage.

#### B. Issuable in Series.

The Income Mortgage Bonds may be issued, without limit as to aggregate amount or within such limit as may be specified in the Income Mortgage, from time to time in different series, subject to such limitations and restrictions as may be specified in the Income Mortgage, payable on such date or dates, in such denominations, bearing interest at such rates and containing such provisions in regard to accumulation of interest, redemption, conversion, taxes, place or places and money or moneys of payment, registration and sinking funds, and having such other characteristics as may be prescribed by the Board of Directors of the New Company at the time of issue, but with respect to the lien of the Income Mortgage all equally secured. No interest shall

be mandatorily payable on Income Mortgage Bonds of any series (except at maturity or redemption) except out of Available Net Income, as hereinafter provided.

C. Income Bonds of Series A to be Issued in Reorganization.

\$26,126,550 of Income Mortgage Bonds, Series A, are to be authenticated and issued in the Reorganization, as set out in Article IV below.

The Income Mortgage Bonds of Series A shall be dated January 1, 1939, shall mature January 1, 2014, shall bear interest at the rate of  $4\frac{1}{2}\%$  per annum, due and payable as hereinafter provided, and shall be redeemable, in whole or in part, on May 1 in any year, on thirty days' notice at their principal amount plus (a) full interest for the last preceding year and all unpaid accumulated interest for prior years and (b) interest at the rate of  $4\frac{1}{2}\%$  per annum from the last preceding December 31 to the redemption date.

The Income Bonds of Series A shall be convertible into shares of Common Stock, as at the time constituted, at any time at the rate of 15 shares for \$1,000 principal amount of such Bonds.

Interest on Income Mortgage Bonds, Series A, accruing for each calendar year shall (up to the limits of accumulation hereinafter specified) become absolutely due as a debt on December 31 in such year, but shall be payable on May 1 of the next succeeding year or thereafter as provided below. Such interest

shall be mandatorily payable (except as hereinafter provided) only out of Available Net Income of the New Company that remains after providing for the Capital Fund and changes prior thereto (i.e., that remains after the deductions made pursuant to paragraphs (1) and (2) of Subdivision G of Section 3 of this Article II). All interest that comes due and is not paid on the next following May 1 shall accumulate up to the maximum amount of  $13\frac{1}{2}\%$ , but not beyond. Accumulated interest shall be mandatorily payable (a) whenever, and to the extent that, there is Available Net Income for any subsequent year remaining after the deductions made pursuant to said paragraphs (1) and (2) of Subdivision G (in which case such amount shall be paid on the next following May 1), or (b) in any event (whether earned or not) at the maturity or on redemption of the Income Mortgage Bonds of Series A. For the purposes of the two sentences next hereinabove payments of interest shall be considered as applied to interest accrued for the last preceding calendar year before being applied to accumulations. The Board of Directors of the New Company may at any time, in its discretion, pay any interest accrued on the Income Mortgage Bonds, Series A, even if not earned, out of any funds lawfully available therefor.

The Income Mortgage will provide for the payment on May 1 of each year while any Income Mortgage Bonds, Series A, are outstanding of an installment of Sinking Fund, if earned, as, and in the

amount, hereinafter specified. Such instalment shall be payable only out of Available Net Income for the last preceding calendar year that remains after paying interest on outstanding Income Mortgage Bonds (i.e., that remains after the deductions made pursuant to paragraphs (1), (2) and (3) of said Subdivision G). The amount of such instalment shall equal (a)  $1\frac{1}{2}$  of 1% of the maximum principal amount of Income Mortgage Bonds, Series A, theretofore at any one time authenticated and uncanceled, plus (b) an amount equal to interest on all Income Mortgage Bonds, Series A, theretofore purchased or redeemed out of the Sinking Fund, calculated at the rate paid on said May 1 upon outstanding Income Mortgage Bonds of Series A. Such [784] accruals of the Sinking Fund instalments shall not be cumulative. The Sinking Fund shall be applied from time to time to the retirement of Income Mortgage Bonds, Series A, by purchase in the open market or by call for tenders at not exceeding their redemption price, and whenever the amount in the Sinking Fund exceeds \$50,000 and Income Mortgage Bonds, Series A, are not tendered or cannot otherwise be purchased at less than their redemption price, the funds then in the Sinking Fund shall be applied to the redemption of the Income Mortgage Bonds, Series A, on the next succeeding interest payment date. All bonds so acquired shall be cancelled and no bonds may be issued to refund any such bonds.

D. Issue of Additional Income Mortgage Bonds.  
Income Mortgage Bonds, in addition to those to be issued in the reorganization, may be issued from time to time to refund outstanding Income Mortgage Bonds or, in lieu of First Mortgage Bonds, for the purposes and subject to the restrictions stated under "Issue of Additional First Mortgage Bonds" above, to the extent that First Mortgage Bonds are not issued for such purposes.

E. Restrictions Designed to Encourage Future Financing Through Stock and Restrictions on Pledges.

No Income Mortgage Bonds (other than those to be issued under the Plan) may be authenticated and delivered unless (1) the New Company shall have contracted forthwith to sell or pledge such bonds and (2) the Board of Directors of the New Company, by resolution adopted by two-thirds of the entire number of directors, shall have determined that, in the opinion of the Board, taking into account market and all other relevant conditions at the time, it is impracticable to provide the amount of money needed (a) by the sale of Preferred Stock at a price which would give a current dividend return of 6% or less, or (b) by the sale of Common Stock at a price (not less than \$50 per share) which would give a current dividend return (based on the regular dividend rate then in effect, or, if no regular dividend rate is in effect, on the average rate

at which dividends shall have been paid during the last twelve calendar months) of 6% or less.

The Income Mortgage will also contain a covenant substantially to the effect that the excess of the aggregate principal amount of all Income Mortgage Bonds under pledge at any one time over the principal amount of all indebtedness so secured shall not exceed 10% of the aggregate principal amount of all Income Mortgage Bonds then authenticated and uncanceled.

#### F. Modification of Income Mortgage.

The Income Mortgage will provide, within conditions and limits to be therein prescribed, for the modification and alteration thereof and of the rights and obligations of the New Company and of the holders of the Income Mortgage Bonds thereunder, at any time by the concurrent action of the New Company and of the holders of not less than 66 $\frac{2}{3}$ % in aggregate principal amount of the bonds then outstanding; provided, however, that no such change or modification shall alter or impair the obligation of the New Company to pay the principal of any bond without the consent of the holder of such bond. In the event of any unification of the properties of the New Company with the properties of any other company, the modifications hereinabove authorized may include provisions excluding in whole or in part the earnings from such other properties in determining Available Net Income and providing for the determination of such Available Net Income without the maintenance of separate accounts.

### G. Determination and Application of Available Net Income.

Available Net Income shall be determined for each calendar year beginning with the year 1939, and continuing thereafter so long as any Income Mortgage Bonds remain outstanding. When no Income Mortgage Bonds remain outstanding, the provisions of this Subdivision G shall cease to be operative.

Available Net Income for each such calendar year shall be determined by deducting all fixed charges of the New Company and its wholly owned railway subsidiaries accrued during such calendar year from the consolidated income of the New Company and its wholly owned railway subsidiaries available for fixed charges for such calendar year (determined in accordance with the accounting rules of the Interstate Commerce Commission or other analogous Federal authority having jurisdiction in the premises at the time in force, or, to the extent not governed by such accounting rules, in accordance with sound accounting practice); provided, however, that if the New Company shall not come into ownership and possession of the properties now operated by the Bankruptcy Trustees on or before January 1, 1939, Available Net Income for any period after January 1, 1939, until the New Company comes into ownership and possession of such [785] properties shall be computed as if the New Company had come into such ownership and possession on January 1, 1939 and had issued, as of that date, the new securi-

fies issuable under the Plan, other than the \$10,000,000 of new First Mortgage Bonds, Series A, and in lieu of interest on such Bonds there shall be charged the amount of interest actually accruing during such period upon any then outstanding Trustees' Certificates or other obligations issued to provide funds for rehabilitation purposes.

Available Net Income shall be ascertained for each such calendar year, as the accounts shall be stated on the books of the New Company during such calendar year, without adjustments, except that: (1) if in respect of any calendar year the Available Net Income is a deficit, the amount of such deficit may, in the discretion of the Board of Directors of the New Company, be carried forward and be deducted in determining Available Net Income for the succeeding calendar year or calendar years until such deficit (or accumulated or remaining deficits) be extinguished by earnings which in the absence of such deficit or deficits, would be Available Net Income; and (2) debits or credits to adjust income in prior years shall be treated as income items for the year in which entered on the books whether cleared through income or profit and loss accounts, so far, but only in so far, as such debits and credits reflect cash receipts or disbursements in the year in which they are entered on the books.

Available Net Income for each calendar year shall be applied to the following purposes and in the following order:

(1) To the creation, if and when the aggregate principal amount of First Mortgage Bonds outstanding shall equal or exceed \$20,000,000, of the Sinking Fund provided for in Clause 1 of Subdivision B of Section 2 hereinabove, in an amount up to, but not exceeding, in respect of any calendar year,  $\frac{1}{2}$  of 1% of the maximum principal amount of First Mortgage Bonds theretofore at any one time authenticated and uncanceled.

(2) To the creation of a Capital Fund to be applied to, or to provide for, or to reimburse the treasury of the New Company for, Capital Investments, as defined by the Interstate Commerce Commission's Classification of Income, Profit and Loss and General Balance Sheet Accounts for Steam Railroads, Accounts Nos. 701 Investment in road and equipment, 702 Improvement on leased railway property and 705 Miscellaneous physical property (or advances to subsidiaries for expenditures which, if made directly by the New Company in respect of its owned or leased properties, would be charged to said accounts), or such substituted accounts as may at the time be in effect, to the extent that such Capital Investments have been made or contracted for during such calendar year or within three months thereafter, and including therein (but only to the extent that such payments during such calendar year shall exceed depreciation of equipment charged against income for such calendar year) payments made for new equipment, or initial and principal payments upon equipment leased under equipment trusts or

purchased under conditional sale agreements and instalments of sinking fund provided for by paragraph (b) of Subdivision E of Section 2 of this Article II (relating to First Mortgage Bonds issued for equipment), provided, however, that

(a) The annual amount set aside in the Capital Fund shall be \$300,000, which amount shall be cumulative, provided, however, that (1) if the Board of Directors of the New Company in its discretion shall so determine, additional amounts not exceeding \$200,000 in respect of any calendar year may be set aside in the Capital Fund, and (2) the amount in the Capital Fund unappropriated shall not exceed \$1,000,000 at any one time.

(b) The Capital Fund may be applied only to such part of the cost of Capital Investments as hereinabove defined as remains after deducting from such cost all retirements of roadway and structures charged against income in such calendar year;

(c) To the extent that expenditures are so provided for or reimbursed out of the Capital Fund, the Company shall not thereafter have the right to issue any bonds or other evidences of indebtedness or any stock ranking, as to either assets or dividends, in priority to, or on a parity with, the Preferred Stock, 5% Series, to capitalize or reimburse such expenditures; provided, however, that such expenditures (if for purposes for which First Mortgage Bonds

or Income Mortgage Bonds may be issued) may, within such limits, if any, as may be specified in the First Mortgage or the Income Mortgage, be used to supply, in whole or in part, the excess of capital expenditures required to be certified under either such mortgage over the principal amount of the Bonds that may be issued under the terms thereof; and [786]

(3) Any then remaining Available Net Income for any calendar year shall be applied to the payment on the next succeeding May 1, of interest on the then outstanding Income Mortgage Bonds (not including any thereof then held in any sinking fund) accrued during the last preceding calendar year, and of any accumulated unpaid interest thereon.

(4) Any then remaining Available Net Income for any calendar year shall be applied, so long as any Income Mortgage Bonds, Series A, are outstanding, to the payment on the next succeeding May 1, of the sinking fund instalment provided for in Subdivision C of this Section 3 (relating to Income Mortgage Bonds, Series A).

(5) Any then remaining Available Net Income for any calendar year may be applied to the creation of a sinking fund for Income Mortgage Bonds of series other than Series A, if any such sinking fund shall have been provided for at the time of the creation of any such series:

(6) Any then remaining Available Net Income for any calendar year shall be applied to the pay-

ment on the next succeeding May 1 of the instalment, if any, then due under the sinking fund provisions of Clause (2) of Subdivision B of Section 2 hereinabove (relating to First Mortgage Bonds when outstanding in excess of certain limits).

(7) Any then remaining Available Net Income for any calendar year may be applied to any proper corporate purpose of the New Company (except dividends on the new Common Stock), including, if, and to the extent that such dividends shall be declared by the Board of Directors of the New Company, the payment of dividends upon the Preferred Stock in respect of such year and of any accrued and unpaid cumulative dividends on the Preferred Stock; such dividends to be paid, except as hereinafter provided, on such date or dates in the next succeeding year as may be specified in the Certificate of Incorporation or By-Laws of the New Company, or in the certificates for the Preferred Stock.

(8) Any then remaining Available Net Income for any calendar year may be applied to any proper corporate purpose of the New Company, including (but only after all accrued and unpaid cumulative dividends on the Preferred Stock to the end of such year shall have been paid, or declared and set apart for payment) dividends on the Common Stock.

No interest need be paid on Income Mortgage Bonds if the amount to be paid is less than  $\frac{1}{4}$  of 1%. Any excess available for interest but not paid because of the foregoing provision shall be reserved and added to the income available for interest on

the Income Mortgage Bonds for the next succeeding calendar year.

If there are outstanding Income Mortgage Bonds of different series, the amount applicable to interest on such bonds shall be distributed among the respective series in proportion to the unpaid interest at the time accumulated on the bonds of such series, respectively.

Dividends may be paid on stock of any class (subject to the relative rights of the several classes of stock) out of the income of any calendar year prior to the close of such calendar year if, but only if, prior to the declaration of such dividends, the Board of Directors shall have determined that the Available Net Income for such year applicable for the purposes specified in the foregoing paragraphs (1), (3), (4), (5) and (6) will be more than sufficient to pay the amounts payable out of such Available Net Income pursuant to said paragraphs and such amounts shall have been deposited in trust for the purposes specified in said paragraphs. Dividends on Common Stock may be so declared only if, prior to such declaration, the Board of Directors shall have determined that the applicable part of Available Net Income for such year will be more than sufficient to pay the amount hereinabove specified for dividends (including accumulations) on the Preferred Stock and such amount shall have been deposited in trust for the purpose of paying such dividends.

#### 4. Preferred Stock

##### A. Authorized Issue.

There will be authorized 750,000 shares of Preferred Stock, each of the par value of \$100, of which 285,722 shares of a 5% Series are to be issued in the reorganization as set out in Article IV below.

The additional authorized Preferred Stock not issued in the reorganization will be issuable from time to time in the discretion of the Board of Directors of the New Company, but (unless for purposes for which First Mortgage Bonds might otherwise have been issued) only after the concurring vote or consent of the [787] holders of a majority of the outstanding Preferred Stock. So far as permitted by law, such additional Preferred Stock may be of the 5% Series issued upon this reorganization, or of any other series, one or more, and Preferred Stock of any such other series may bear dividends at such rate, cumulative or non-cumulative, may be participating or non-participating, may be redeemable or non-redeemable, convertible or non-convertible, and may have such other rights and privileges and be subject to such limitations and restrictions, as may be from time to time determined by the board of directors prior to the issue of Preferred Stock of any such other series.

##### B. Preference on Liquidation.

In any liquidation or winding up of the New Company, whether voluntary or involuntary, the Preferred Stock shall be entitled to receive, out of

the assets of the New Company, its par value, plus any accrued and unpaid cumulative dividends thereon, plus such premium, if any, as may be specified for any series, before any distribution shall be made on the Common Stock, but shall not be entitled to any further participation in such assets.

### C. Voting Rights.

Holders of Preferred Stock shall be entitled to one vote per share on all matters, except that in elections of directors, which shall be by cumulative voting, each holder of stock of either class shall be entitled to as many votes per share as the number of directors to be elected.

The New Company shall not, without the vote or consent of the holders of at least two-thirds in par value of the outstanding new Preferred Stock,

(1) create or permit to be created any mortgage or other lien upon any of its properties, excepting the new First Mortgage, the new Income Mortgage or purchase money liens (including equipment obligations) upon property hereafter acquired, given for not more than 75% of the purchase price of such property; (2) create or issue any bonds, notes or other evidences of indebtedness maturing more than two years from their date, except purchase money obligations given for not more than 75% of the purchase price of property hereafter acquired; (3) create any stock ranking, either as to assets or dividends, in priority to, or on a parity with, the new Preferred Stock, or (4) permit any subsidiary,

all of whose stock except directors' shares, shall be owned by the New Company, to create any mortgage or other lien upon any of its properties or issue any such bonds, notes or other evidence of indebtedness (except purchase money liens or obligations limited as aforesaid), or issue any additional stock of any class, unless the obligations secured by such mortgage or other lien or such other obligations or such stock shall be acquired by the New Company.

**D. Preferred Stock, 5% Series.**

The Preferred Stock, 5% Series, shall be entitled to receive all accumulated unpaid dividends and current dividends at the rate of 5% per annum, in respect of any calendar year before any dividends shall be paid or declared or set apart for payment on the Common Stock in respect of such year. Such dividends shall be cumulative to the extent earned in any calendar year but not paid; but such dividends shall otherwise be non-cumulative. For the purposes of the next preceding sentence hereinabove, Preferred Stock dividends shall be considered to be earned in any calendar year to the extent covered by the Available Net Income for such year that remains after providing for prior charges (i.e., that remains after the deductions made pursuant to paragraphs (1), (2), (3), (4), (5) and (6) of Subdivision G of Section 3 of this Article II); or after the provisions of said Subdivision G shall have ceased to be operative, to the extent covered by net income as defined by the accounting rules or prac-

tice referred to in said Subdivision G). If there are outstanding shares of Preferred Stock of different series, the earnings applicable to dividends thereon shall be apportioned among the respective series in proportion to the dividends accumulated on the shares of such series respectively.

After dividends shall have been paid or declared or set apart for payment, on the new Common Stock at the rate of \$3 per share in respect of any year, each share of Preferred Stock, 5% Series, shall be entitled to share equally with each share of new Common Stock in any dividends paid or declared or set apart for payment, in respect of such year.

The Preferred Stock, 5% Series, shall be redeemable, in whole or in part, at any time at its par value plus accrued and unpaid cumulative dividends, and proportionate dividend for the current year.

The holders of Preferred Stock, 5% Series, shall not have any preemptive right to subscribe to any additional issues of stock of any class or of securities convertible into stock of any class. [788]

### 5. Common Stock

There will be authorized 1,250,000 shares of Common Stock, without par value, of which 525,300 shares are to be issued in the reorganization as set forth in Article IV below and 522,531 shares shall be reserved for the conversion of Income Mortgage Bonds, Series A.

Holders of Common Stock shall be entitled to one vote per share on all matters except that directors shall be elected by cumulative voting as aforesaid.

So far as permitted by law, any vote or consent by the holders of Common Stock, authorizing the issuance of additional shares of stock of any class or of securities convertible into stock of any class, may waive, on such terms and conditions, if any, as may be specified in such vote or consent, the preemptive right of all the holders of shares of Common Stock to subscribe to such additional shares or securities.

### III.

#### Reconstruction Finance Corporation and Provision of New Money

\$10,000,000 of new money is required by the New Company for the purpose of retiring Trustees' Certificates issued to provide for the expenditures under the 1936, 1937 and 1938 rehabilitation program. Said \$10,000,000 in new money is to be provided for by the sale at par and accrued interest to R. F. C. (subject to approval and authorization of the Interstate Commerce Commission and the delivery to R. F. C. of a legal opinion satisfactory to it as to the validity of the acquisition by the New Company of title to the properties of the Debtor and the validity of the new First Mortgage Bonds and the new First Mortgage) of the \$10,000,000 of First Mortgage 4% Bonds, Series A; due 1989, to be issued in the reorganization.

As consideration for R. F. C.'s providing said new money by purchasing said First Mortgage Bonds, R. F. C.'s existing claim against the Company, amounting as of January 1, 1939, to \$3,

\$862,870 (\$2,963,000 principal and \$899,870 interest) and represented by notes secured by collateral junior to the existing First Mortgage Bonds of the Company, shall be provided for under the Plan in like securities and in like proportions as those given holders of the Company's existing First Mortgage Bonds.

The New Company will enter into an agreement with R. F. C. that so long as R. F. C. shall own \$5,000,000 of said First Mortgage Bonds, the New Company will not, without the prior consent of R. F. C., issue bonds under the First Mortgage in excess of the aggregate principal amount at any one time outstanding of \$20,000,000.

#### IV.

##### Treatment of Existing Securities

1. Existing equipment trusts, Baldwin lease and Pullman contract, aggregating \$2,750,050, shall remain undisturbed and shall be assumed by the New Company.

2. Holders of existing First Mortgage Bonds will receive for each \$1,000 principal amount thereof, together with \$266,66 $\frac{2}{3}$  of interest accrued and unpaid thereon to January 1, 1939:

\$500 Income Mortgage 4 $\frac{1}{2}$ % Bonds, Series A (being 50% of the principal amount of existing Bonds);

\$500 Preferred Stock, 5% Series (being 50% of the principal amount of said Bonds); and

Five and one-third shares of Common Stock, without par value.

3. R. F. C. will receive in respect of the \$10,000,000 of new money provided for in Article III (or the surrender of Trustees' Certificates at their principal amount and accrued interest, to a like amount) and its existing claim in the principal amount of \$2,963,000, together with \$899,870 of interest accrued and unpaid thereon to January 1, 1939:

\$10,000,000 New First Mortgage 4% Bonds, Series A (being 100% of said new money);

\$1,481,500 Income Mortgage 4½% Bonds, Series A (being 50% of the principal of the said claim);

~~\$1,481,500~~ Preferred Stock, 5% Series (being 50% of the principal of the existing claim); and

Seventeen thousand nine hundred and ninety-five shares of Common Stock, without par value. [789]

4. R. F. C. will receive in respect of its claim in the principal amount of \$2,445,610, together with \$146,503 of interest accrued and unpaid thereon to January 1, 1939:

\$2,445,610 Preferred Stock, 5% Series (being 100% of the principal of said claim); and

Twenty-nine hundred and thirty Shares of Common Stock without par value.

Subject to reduction by the application, prior to the date of issue of the new securities under the Plan, of any proceeds from the distributive shares of the Company or its subsidiaries under the Marshaling and Distributing Plan, 1931.

5. A. C. J. will receive in respect of its claim in the principal amount of \$4,999,800 together with \$1,249,950 of interest accrued and unpaid thereon to January 1, 1939:

Seventy-two thousand three hundred and fifty shares of Common Stock, without par value.

6. W. P. RR. Corp. will receive in respect of its claim in the principal amount of \$5,767,543, together with \$1,980,429 of interest accrued and unpaid thereon to January 1, 1939:

Forty-four thousand eight hundred and fifty shares of Common Stock, without par value.

7. Western Realty Company will receive with respect of its claim in the principal amount \$50,000, together with \$11,667 of interest accrued and unpaid thereon to January 1, 1939:

Three hundred and sixty-five shares of Common Stock, without par value.

8. W. P. RR. Corp. will receive in respect to its equity in the Debtor, represented by the difference between the depreciated investment in the Debtor of \$120,000,000 (approx.) and its aggregate debts as of January 1, 1939, with accrued interest, amounting to \$95,698,299:

One hundred twenty-three thousand nine hundred and thirty-five shares of Common Stock of no par value.

## V.

### Claims Not Affected By the Plan

The following claims are not affected by the Plan:

(a) current liabilities of the Company incurred in

the ordinary conduct of its business prior to the institution of the Reorganization Proceeding, which are entitled to priority over one or more of the mortgages of the Company, (b) current liabilities and obligations of the Bankruptcy Trustees incurred during the Reorganization Proceeding, and (c) expenses of reorganization allowed by the Court within the maximum limits fixed by the Commission. To the extent that such claims, liabilities or obligations are not paid by the Company or the Bankruptcy Trustees pursuant to order of the Court, they are to be paid in cash or assumed by the New Company, provided that any amounts so assumed by the New Company shall constitute a charge upon the properties of the New Company prior in lien to all new securities issued under the Plan. All such claims, liabilities and obligations may be adjusted or compromised and dealt with or paid or discharged by the New Company, all as may be determined by the Board of Directors of the New Company subject to approval by the Court.

The New Company shall be deemed to have assumed such of the contracts of the Company which are executory in whole or in part and which by their terms do not terminate at or prior to the conclusion of the Reorganization Proceeding, including any executory leases and liabilities under guaranties, as shall have been affirmed by the Bankruptcy Trustees with the approval of the Court, or shall not have been disaffirmed by the Bankruptcy Trustees, prior to the date of confirmation of the Plan, and

also any executory contracts made by the Bankrupt Trustees with the approval of the Court which by their terms do not terminate at or prior to the conclusion of the Reorganization Proceeding.

## VI.

### Method of Executing the Plan

Existing mortgages on the Company's properties shall be released and cancelled, and all funds on deposit with the Trustee under the Company's mortgages representing sums paid from time to time to [790] such Trustees for the release of properties, sale of scrap, and otherwise; and all collateral pledged under the Company's mortgages, shall be surrendered to the New Company free from liens of the Company's mortgages, after deductions therefrom of any amounts which the Court may find should be deducted under the provisions of such mortgages and consistent with this Plan. All collateral pledged by others than the Company as security for the Company's notes to R. F. C., R. C. C. and A. C. J. shall be surrendered to the pledgors thereof, and all collateral pledged by the Company as security for said notes shall be surrendered to the New Company and cancelled, except that R. C. C. shall not release or surrender any right or interest in the distributive shares of the Company or its subsidiaries under the Marshaling and Distributing Plan, 1931, but any proceeds from such distributive shares after the effective date of the Plan, shall become the property of and be retained by the

R. C. C., but to the extent to which received prior to the issue of the new securities under the Plan shall be applied in reduction of the claim of the R. C. C. in respect of which such new securities are to be issued at the rates provided in Article IV.

The Plan shall be carried out under the supervision of a Reorganization Committee consisting of five persons, three to be selected by vote of the existing First Mortgage Bondholders in such manner as the Commission shall direct, one by R. F. C., and one by A. C. J. The selections shall be communicated to the Court for its consideration, and designated by the Court immediately upon confirmation of the Plan. Any vacancy which may occur in the Committee shall be filled through a new selection by the person or persons who had selected the retiring member.

The Plan may be carried out either by re-vesting the properties formerly of the Company in the Company or by transferring said properties to a new corporation organized for the purpose, and the execution by the corporation in which said properties are vested of the new mortgages and the issue by it of the new securities contemplated by the Plan.

Subject to any requirements of law and to the requisite approval of the Court and the Commission, the Reorganization Committee shall have the power to provide the method by which creditors and other interested parties may participate in the Plan, to determine the form, and, except as herein otherwise expressly provided, the provisions, of all mortgages.

bonds, coupons, charters, by-laws, stock certificates, voting trust certificates, acceptances, assents, and all other instruments in the judgment of the Reorganization Committee necessary or desirable in connection with carrying out the Plan, and to take all such action and to enter into such arrangements, financial and otherwise, as the Reorganization Committee may deem necessary or advisable, in order to consummate and carry into execution the Plan or any modification thereof.

The Reorganization Committee may act by a majority of its members as from time to time constituted, at a meeting or in writing without a meeting. The Reorganization Committee may employ such agents, attorneys and others as it may deem desirable for the purposes of the Plan. The Reorganization Committee may from time to time delegate to others any power or discretion conferred upon it by the Plan, and the members of the Reorganization Committee shall not be liable for any action taken by them in good faith or by any person employed by the Reorganization Committee in good faith, or otherwise, except for their respective individual malfeasance or neglect. The terms of any solicitation of deposits of securities or authorizations to represent shall be subject to the approval of the Commission.

In case any class of creditors or stockholders shall not accept the Plan pursuant to Section 77, any party may nevertheless move the Court to confirm the Plan on the ground that the interests of such

class of creditors have no value, or, as the case may be, that the equity of such class of stockholders has no value, or on the ground that the Plan provides for payment in cash to such class of an amount not less than the value of their interests or equity, if any, in accordance with subdivision (c) of Section 77, through the sales hereinafter provided for in accordance with clause 5 of subdivision (b) of Section 77.

If so ordered by the Court, the Plan may be executed by a sale at public auction, at not less than a fair upset price as determined by the Court, of all or any part of the properties and assets of the Company, all on such conditions and in such manner as the Court may direct. Upon any such sale, the properties and assets offered for sale may be purchased for the benefit of the New Company by the Reorganization Committee, and in that event there shall be applied on account of the purchase price the distributive share, if any, of the proceeds of such sale of all securities the holders of which shall have assented to the Plan, and the securities, though not assenting to the Plan, of all classes which shall have accepted the Plan. If the properties and assets of the Company so offered for sale are purchased at any such sale by others than the Reorganization Committee, the Plan shall be deemed inoperative except in so far as provision is made therein for the sale of the properties and assets of the Company at such sale as may be ordered by the Court. [791]

All properties and assets so sold which are purchased by the Reorganization Committee or its representative shall be transferred to the New Company.

In the event of any such sale, the Reorganization Committee may in its discretion sell all or any portion of the new securities distributable under the Plan in respect of securities of any creditor, if neither such creditor nor the class to which such creditor belongs shall have accepted the Plan. The proceeds of any such sale may be used to pay the portion of the purchase price payable in cash in any such sale.

Upon any such sale, non-assenting creditors of any class which shall not have accepted the Plan and the stockholders of either class shall be entitled to receive, in lieu of the securities, if any, otherwise issuable under the Plan, their aliquot proportion of the proceeds of such sale, after deducting therefrom all expenses of such sale and the amount which would be required to pay in full, of principal and unpaid interest accrued to the date of such sale, all creditors whose claims are prior in lien or superior in equity to the claims of such non-assenting creditors or the rights of such stockholders, provided that such non-assenting creditors and such stockholders shall have the right, if they shall notify the Reorganization Committee within a period of 30 days after the approval of such sale by the Court, to assent to the Plan and receive the securities allocated to them under the Plan in lieu of their aliquot share of the proceeds of such sale.

## VII.

## Construction of the Plan

The construction of the Plan by the Court shall be final and conclusive. The Court may cure any defect, supply any omission, or reconcile any inconsistency in such manner or to such extent as may be necessary or expedient in order to carry out the Plan effectively. Acceptance of the Plan shall include acceptance of the provisions of the Mortgage, the bonds issued thereunder in the reorganization, the stock certificates, and all instruments necessary and appropriate to the carrying out of the Plan, to the same effect as if the terms of such documents and instruments were set forth in full herein.

## VIII.

## Management

The Board of Directors of the New Company shall consist of not less than seven nor more than eleven members who shall be elected by the holders of the Preferred Stock and the Common Stock of the New Company at an election to be held not later than ninety days after the consummation of the Plan. Pending such election the Board of Directors shall consist of such persons as may be designated by the Reorganization Committee with the approval of the Court.

[Endorsed]: Filed Oct. 5, 1939. [792]

Interstate Commerce Commission

Finance Docket No. 10913

**WESTERN PACIFIC RAILROAD COMPANY  
REORGANIZATION**

Submitted August 3, 1939.

Decided September 19, 1939.

Upon further consideration of the record and the petition of the Western Pacific Railroad Company for modification of the plan for the reorganization of the Western Pacific Railroad Company approved October 10, 1938, as modified and approved on June 21, 1939, petition denied.\*

Appearances as in prior reports.

**REPORT OF THE COMMISSION ON CON-  
SIDERATION OF PETITION FOR FUR-  
THER MODIFICATION OF APPROVED  
PLAN OF REORGANIZATION.**

By the Commission:

By our report and order issued October 10, 1938, in this proceeding, we approved a plan for the reorganization of the Western Pacific Railroad Company, hereinafter called the debtor, pursuant to the provisions of section 77 of the Bankruptcy Act, as amended, 230 I. C. C. 61. On December 30, 1938,

\*Previous reports 207 I. C. C. 793, 230 I. C. C. 61, and 233 I. C. C. ....

pursuant to petitions filed by the debtor and certain interveners for modifications of the plan we had approved, we reopened the proceeding for further consideration. On June 21, 1939, after having heard the parties on oral argument concerning the petitions, we issued our report and order approving a modified plan for the reorganization of the debtor.

On August 2, 1939, the debtor filed a petition for a rehearing of its petition for a modification of our report and order of October 10, 1938; and for a modification of the [793] modified plan of reorganization approved by our report and order of June 21, 1939, proposing therein a plan of reorganization, herein referred to as the new plan, in substitution of the modified plan approved by us on June 21, 1939.

By the new plan it is proposed to make the maturity date of the new first-mortgage bonds 1989 instead of 1974 and to make the capital fund mandatory at \$300,000 and permissible up to \$500,000 instead of mandatory at \$500,000 as in the approved plan. It is proposed to increase the number of shares of no-par value common stock from 319,441 shares to 525,300 shares. Under the approved plan the common stock is allocated, 72.19 percent to the present first-mortgage bondholders, 4.94 percent to the Reconstruction Finance Corporation, hereinafter called the Finance Corporation, 11.09 percent to the Railroad Credit Corporation, hereinafter called the Credit Corporation, and 11.78 percent to the A. C. James Company. The new plan

would allocate 50.04 percent to the first-mortgage bondholders, 3.43 percent to the Finance Corporation, 0.56 percent to the Credit Corporation, 13.77 percent to the A. C. James Company, 8.54 percent to the Western Pacific Railroad Corporation in its capacity as a general creditor, 23.59 percent to the Western Pacific Railroad Corporation in its capacity as stockholder, and 0.07 percent to the Western Realty Company as a general creditor.

The new plan proposes \$26,126,550 of new income-mortgage bonds, an increase of \$4,907,475 over the \$21,219,075 provided in the approved plan. Under the new plan the first-mortgage bondholders and the

[793-A]

Finance Corporation would each be given 50 percent of the principal of their securities in income-mortgage bonds and 50 percent in preferred stock, instead of 40 percent in income bonds and 60 percent in preferred stock as under the approved plan. It would not allocate any income bonds to the Credit Corporation and the A. C. James Company, whereas the approved plan allocated \$154,111 and \$163,724, respectively, to them.

Under the new plan \$28,572,160 par value of preferred stock would be issued in lieu of the \$31,850,297 under the approved plan. The decrease of \$3,278,137 is accounted for by the new proportional basis, above described, for allocating income bonds and preferred stock to the first-mortgage bondholders and the Finance Corporation, by allocating \$2,445,610 instead of \$241,681 to the Credit Corporation, and by allocating none to the A. C. James Com-

pany instead of the \$256,756 under the approved plan.

The fixed interest debt, \$12,750,050, and the yearly interest charges thereon, \$494,202 would be the same under the new plan as under the approved plan. The combined fixed-interest and contingent-interest debt under the new plan would be \$38,876,600, compared with \$33,969,125 under the approved plan. The yearly fixed-interest, capital fund, and contingent-interest charges under the new plan would be \$2,169,897, compared with \$1,949,060 under the approved plan. In this comparison it is assumed that the board of directors would exercise its discretion in favor of increasing the \$300,000 mandatory amount of the capital fund under the new plan to the discretionary amount of \$500,000. Under the new plan the yearly fixed-interest, [794] capital fund, contingent-interest, sinking fund for income bonds, and preferred stock dividend requirements would be \$3,729,138, compared with \$3,647,670 under the approved plan. Under the new plan the total capitalization would be \$67,448,760 plus 525,300 shares of common stock without par-value, compared with \$65,819,422 plus 319,441 shares without par-value under the approved plan.

The debtor states, as one of its reasons, for presenting its petition at this time, that the new plan has been substantially agreed to by the parties. The Credit Corporation joins in the request of the debtor for the substitution of the new plan for the one approved. The A. C. James Company states that it

is willing to accept the proposals of the new plan on condition that it is promptly accepted by all other parties and approved by us, without waiving any of its rights heretofore raised, under any other plan. The committee representing institutional holders of about one-third in amount of first mortgage bonds of the debtor, in its answer to the petition states that in view of the approval by us of a plan of reorganization on June 21, 1939, it is now unable to recommend to the security holders which it represents, the compromise proposed in the new plan, although it was willing to do so prior to that order. It now opposes the reopening of the record of the proceedings before us and prays that the plan heretofore approved by us be certified to the court immediately.

The debtor explains in its brief accompanying its petition that acceptance of the plan by the Western Pacific Railroad Corporation must be made subject to the subsequent approval of the stockholders of that corporation, but that [794-A] concentration of large amounts of the stock in the ownership of interests identified with the present management of the debtor reasonably assures the prompt acceptance of the plan by such stockholders. It urges that our approval of the new plan would assure an early reorganization of the debtor and that it would forestall litigation likely to arise under the approved plan between the interests junior to the first-mortgage bondholders and the first-mortgage bondholders.

## Conclusions

We are not satisfied that the mandatory feature of the capital fund should be reduced from \$500,000 to \$300,000. In both of our prior reports we found in effect that yearly contributions of \$500,000 to the capital fund were essential to meet the debtor's requirements. In our report of June 21, 1939, we considered requests that the yearly contributions to the capital fund be reduced to \$300,000. The debtor's petition does not offer to prove or set forth facts even tending to show that we were in error in our finding that the capital fund should be mandatory at \$500,000.

The allocation of 8.54 percent of the new common stock to the Western Pacific Railroad Corporation, in its capacity as a general creditor, and 23.59 percent to it, in its capacity as a stockholder, and 0.07 percent to the Western Realty Company as a general creditor would require a reversal of our findings that those interests have no value, or a finding that the concessions required of the senior interests are justified and are compensated by concessions to be made by the junior interests. This proposed sharing of common stock affects also our previous finding as to what constitutes fair and equitable treatment of part of the interests of [795] the first-mortgage bondholders. The debtor's petition does not set forth or offer to prove facts indicating that our findings with respect to these matters were erroneous or furnish any other basis for a finding

that the proposed new plan would be fair and equitable.

In our report of October 10, 1938, we found that the total annual fixed and contingent interest charges of the reorganized company, plus requirements for the capital and sinking funds, should not exceed \$2,000,000 per annum. In our report of June 21, 1939, we modified that finding to the extent of approving a plan by which those annual charges would slightly exceed \$2,000,000, viz, \$2,055,155. Under the new plan those charges would be \$2,300,530. There has been no showing or offer of proof of new facts or changed conditions that would warrant our modifying our basic finding to that extent.

We are not persuaded that there is justification for changing the relationship of fixed debt to total capitalization from that of the approved plan to that resulting from the capitalization under the new plan.

Nor do the responses we have received warrant our regarding the new plan as one agreed to by the parties.

For the reasons stated, the petition will be denied.

An appropriate order will be entered.

Eastman, Commissioner, concurring:

I agree, subject to the reservations in my expression of partial concurrence in connection with the prior report.

Commissioner Miller dissents.

Commissioners Aitchison and Splawn did not participate in the disposition of this proceeding.

[795-A]

**ORDER**

At a General Session of the INTERSTATE COMMERCE COMMISSION, held at its office in Washington, D. C., on the 19th day of September, A.D. 1939.

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Finance Docket No. 10913

Western Pacific Railroad Company Reorganization

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Investigation of the matters and things involved in the petition filed August 2, 1939, in the above proceeding, by The Western Pacific Railroad Company, debtor, for a rehearing on its petition filed December 9, 1938, for a modification of the report and order of the Commission of October 10, 1938, approving a plan for the reorganization of the debtor, for a modification of the report and order of the Commission of June 21, 1939, approving a modified plan for the reorganization of the debtor, and for the approval of a plan for the reorganization of the debtor in substitution for the modified plan of reorganization approved by the Commission on June 21, 1939, having been made, and the Commission having further considered the record and having, on the date hereof, made and filed a report containing its findings of fact and conclusions thereon, which report is hereby referred to and made a part hereof:

It Is Ordered, That the petition be, and it is hereby, denied.

By the Commission.

(Seal), W. P. BARTEL,  
Secretary.

[Endorsed]: Filed Sept. 26, 1939. [796]

[Title of District Court and Cause.]

OBJECTIONS OF A. C. JAMES CO., TO COMMISSION PLAN OF REORGANIZATION, STATEMENT OF CLAIMS FOR EQUITABLE TREATMENT, AND PETITION FOR AMENDMENT OF SUCH PLAN TO CORRECT DEFECTS THEREIN.

To the Honorable A. F. St. Sure, Judge of the United States District Court for the Northern District of California, Southern Division:

A. C. James Co., a secured creditor of the debtor above named, hereby objects to the Plan of Reorganization of the debtor (hereinafter designated as the "Commission Plan") as promulgated by the Interstate Commerce Commission in its order in Finance Docket No. 10913, dated June 21, 1939, and presents its claims for equitable treatment, pursuant to the provisions of the order of this Court, dated November 8, 1939, and to the provisions of Sub-section (e) of Section 77 of the Bankruptcy Act, and does hereby represent to the Court and petition as follows: [853]

# I. General Objections to Commission Plan.

Subject to the more detailed and specific objections and claims for equitable relief hereinafter set forth, your petitioner objects generally to the Commission Plan of June 21, 1939, on the ground:

(a) That the Commission Plan is not "fair and equitable" as to your petitioner within the purpose and express requirement of Section 77 of the Bankruptcy Act as amended, fails to give due recognition to the legal rights and equitable claims of your petitioner, and discriminates unfairly against your petitioner as a secured creditor in a separate class;

(b) That the Commission Plan is not "fair and equitable" to your petitioner and other creditors secured by the General and Refunding Mortgage of the debtor, in that said plan is based in part upon a determination by the Commission that the property of the debtor which is subject to the lien of the General and Refunding Mortgage but is free from the lien of the First Mortgage of the debtor, in insufficient in value to fully secure all the debts secured by the General and Refunding Mortgage, with interest, which determination is beyond the authority of the Commission under Section 77 of the Bankruptcy Act, is contrary to the evidence, and is contrary to law;

(c) That the Commission, while apparently adopting the valuation of the property previ-

ously found by it under Section 19 (a) of the Interstate Commerce Commission Act, and recognizing the undisputed investment in the property of the debtor heretofore made, has completely disregarded such valuation and such investment, without authority of law, and, in the Plan which it has originated and promulgated, seeks to im- [854] pose a capital structure based not upon evidence of values, but on a mere estimate of future earnings and a theory that the Commission should not authorize a capital structure which includes capital stock on which dividends are unlikely to be paid in the near future; this capital structure unnecessarily produces gross discrimination as between various classes of investors in the property, including your petitioner, and results in a complete disregard of the legal rights and equitable claims of general creditors and equity owners in the property;

(d) That the Commission Plan is not in conformity with the law of the land and that the manner in which it was conceived and promulgated is without support under Section 77 of the Bankruptcy Act;

(e) That in numerous instances, the Commission in the course of the hearings before it, over the objections and exceptions of your petitioner, erred in its rulings respecting the competency and admissibility of evidence; with the result that the findings made and the conclu-

sions reached by the Commission and the plan of reorganization certified by it to this Court, as set forth in the Commission's order dated June 21, 1939, are in important respects based upon evidence which is incompetent, irrelevant and insufficient in law;

(f) That in sundry instances, more specifically set forth below, the Commission has made findings of fact which are unsupported by and contrary to the evidence presented and determinations of questions of law which are without justification under Section 77 of the Bankruptcy Act and in violation of the law of the land; and

(g) That in sundry other respects, more specifically set forth below, the Commission, by its Plan, unnecessarily and without authority in law, seeks to im- [855] pose burdens upon the several classes of creditors and investors whose legal and equitable interests in the property of the debtor are entitled to due recognition.

(h) That Section 77 of the Bankruptcy Act, as amended, as interpreted and applied in the Commission Plan is unconstitutional and void in that the Commission Plan takes from your petitioner valuable rights in the property of the debtor without just compensation, all in violation of the provisions of the Fifth Amendment to the Constitution of the United States, upon

which your petitioner relies and the provisions of which your petitioner respectfully invokes.

To all of which your petitioner objects, and presents its claims for equitable treatment, all as is set forth in detail and specifically below.

II. Petitioner's claim: Origin, evidence, security and purpose for which funds were used.

Your petitioner is a secured creditor of the debtor in the principal amount of \$4,999,800, together with unpaid accrued interest thereon at the rate of 5 per cent per annum from January 1, 1934, which unpaid interest to January 1, 1939 (the effective date of the Commission Plan) amounted to \$1,249,950, or an aggregate debt on the date specified of \$6,249,750.

This indebtedness resulted from cash advances made by your petitioner to the debtor from time to time during the years 1931 and 1932. It was originally represented, pursuant to authority granted by the Interstate Commerce Commission, by Five Per Cent Gold Debentures of the debtor, which debentures had been issued under the Indenture dated as of July, 1930, made by and between the debtor [856] and The Chase National Bank of the City of New York, as Trustee.

The indebtedness is now evidenced by three promissory notes of the debtor, the principal amount, date, and date of maturity of which are respectively as follows:

	Principal Amount	Date	Maturity
(1)	\$4,504,000	March 28, 1932	March 28, 1935
(2)	347,000	March 28, 1932	March 28, 1935
(3)	148,800	May 31, 1932	May 31, 1935

The notes now held by your petitioner are secured as follows: By \$6,249,500 principal amount of the debtor's General and Refunding Mortgage bonds, issued under an indenture dated as of January 1, 1932, executed by the debtor to The Chase National Bank of the City of New York, as Trustee, which General and Refunding Mortgage bonds were deposited with and are now held by your petitioner; except that \$2,000,000 principal amount of said bonds, at the request of the debtor, were delivered by your petitioner to The Railroad Credit Corporation, to be held by said The Railroad Credit Corporation as additional collateral against advances made to the debtor by said The Railroad Credit Corporation, your petitioner retaining all its rights as lienor in and to said \$2,000,000 principal amount of the debtor's General and Refunding Mortgage bonds, subject only to the prior rights which have accrued to The Railroad Credit Corporation as first lienor from the acts of the parties set in this paragraph.

All these cash advances made by your petitioner to the debtor in 1931 and 1932 were applied by the debtor to the costs of constructing the Northern California Extension of the debtor, which has been held by the Interstate Commerce Commission (as-

suming a jurisdiction which is not clearly granted to the Commission under Section 77 of the [857] Bankruptcy Act, as amended, or elsewhere) to be subject to the lien of the First Mortgage of the debtor. Said Northern California Extension is an important source, present and prospective, of earnings to the debtor.

A proof of claim was duly filed by your petitioner in the above entitled proceedings for reorganization of the debtor.

By an order, entered August 20, 1935, this Court classified the above described claim of your petitioner as a separate and distinct class for the purposes of Section 77 of the Bankruptcy Act, as amended.

III. Status of debtor as to liabilities and assets on January 1, 1939.

The Commission Plan uses the basic date of January 1, 1939. The total liabilities of the debtor on that date, including the outstanding equipment trusts and leases, Trustees Certificates, First Mortgage bonds, claims of the secured creditors and claims of the general creditors, with interest in all cases accrued to January 1, 1939, as reported by the Commission, amounted in the aggregate to \$95,699,502.

These obligations were subdivided as follows:

1. Existing Equipment, Trusts, Leases, and Contracts .....	\$ 2,750,050	
2. Trustees Certificates .....	10,000,000	
3. First Mortgage Bonds:		
Principal .....	\$49,290,100	
Interest .....	13,143,777	62,433,877
4. Claims of Creditors:		
Reconstruction Finance Corporation:		
Principal .....	\$ 2,963,000	
Interest .....	899,870	3,862,870

[858]

The Railroad Credit Corporation:

Principal .....	\$ 2,445,610	
Interest .....	146,503	2,592,113

A. C. James Co.:

Principal .....	\$ 4,999,800	
Interest .....	1,249,950	6,249,750

The Western Pacific Railroad Corporation:

Principal .....	\$ 5,768,746	
Interest .....	1,980,429	7,749,175

The Western Realty Company:

Principal .....	\$ 50,000	
Interest .....	11,667	61,667

\*These figures are from the books of the debtor.

Against these debts stands on the record before the Court, property of the debtor company which the Interstate Commerce Commission, under Section 19(a) of the Interstate Commerce Commission Act, had valued for rate purposes, with allowances for "the net costs of additions and retirements" to December 31, 1935, at \$139,600,455 (Report of October 10, 1938, pages 24-25).

It is not denied that the depreciated investment of the property of the debtor company would amount to upwards of \$120,000,000 (Record, Ex. 29, Statement 16, page 2; see also opinion of Commissioner Miller, Report of October 10, 1938, page 73).

Petitioner contends that the debtor is not insolvent, and that the property of the debtor represents an investment and present value substantially in excess of the total debts of the debtor with interest accrued to January 1, 1939.

The equity in the debtor represented by the excess of the investment in its property and its present value over and above its present debts constitutes an asset of The [859] Western Pacific Railroad Corporation, a Delaware corporation, which owns all the capital stock of the debtor, consisting of \$28,300,000 of preferred stock, and \$47,500,000 of common stock, all of which stock was issued in the 1916 reorganization of the debtor's operating predecessor, in exchange for first mortgage bonds previously outstanding as evidencing investment in the property now owned by the debtor.

#### IV. Relation of petitioner to other parties in interest in proceeding.

The only direct interest of your petitioner in securities of the debtor company is its interest as a secured creditor, set forth in Section II above. However, corporations affiliated with your petitioner, and directors and officers of your petitioner, hold or control in the aggregate upwards of \$9,000,000 principal amount of First Mortgage bonds of the debtor. In addition, corporations affiliated with your petitioner, and directors and officers of your petitioner, hold or control in the aggregate approximately 40% of the outstanding voting stock of The Western Pacific Railroad Corporation, which has a substantial claim as a general creditor against the debtor company and also owns all of the outstanding stock, preferred and common, of the debtor company.

#### V. Origin of Commission Plan and relation of the various parties thereto.

The Commission Plan is neither an "agreed-upon plan", nor a plan prepared and submitted to the Commission by any party in interest.

In the original proceedings before the Commission three plans were submitted to the Commission by parties to the [860] proceeding: (a) the Debtor Plan, under date of February 8, 1936; (b) the Institutional Bondholders Committee Plan, under date of September 28, 1936; and (c) the plan prepared and submitted by your petitioner, under date of October 26, 1936.

The Commission Plan, as finally promulgated in its Order of June 21, 1939, is not based upon any one of the three above-mentioned plans, but is substantially a plan which the Bureau of Finance of the Commission evolved independently and submitted to the parties in a tentative report on or about August 2, 1937.

After formal hearings, this Bureau of Finance plan, with minor modifications, was approved by the Commission in its Order of October 10, 1938.

When all the parties petitioned for a rehearing, the Commission re-opened the matter and made additional changes in its Plan of October 10, 1938, by adopting certain modifications in that plan urged upon it by counsel for the Institutional Bondholders Committee.

The Commission Plan, as finally promulgated in the Order of June 21, 1939, is satisfactory to the Institutional Bondholders Committee (representing institutions holding only 34.37% of the First Mortgage Bonds) because their full demands for modification in their interest, as asserted at the rehearing before the Commission, were adopted by the Commission.

It is satisfactory to the Reconstruction Finance Corporation because of the substantial preferences granted to it in consideration of its services as an underwriter of the new First Mortgage bonds.

The Commission Plan is inequitable, discriminatory and unsatisfactory to every other party interested in the [861] property: secured creditors, gen-

eral creditors and equity owner. It cannot adequately protect the interests in the property, as a whole, in respect of future financing, future rate problems, and possible consolidations with other properties.

VI. Treatment accorded petitioner's claim under Commission Plan.

In the Commission Plan, your petitioner is allotted for its above stated claim, \$163,724 of Income Mortgage  $4\frac{1}{2}$  Per Cent Bonds, Series A, \$256,756 of 5 Per cent Preferred Stock, Series A, and 37,635 shares of Common Stock of the reorganized company. Such common stock is no par value stock and in the Commission Plan it is allotted to other creditors at prices varying from \$57 to \$62 per share. Using the highest price assigned by the Commission to such common stock, the total allotment of securities to your petitioner amounts to \$2,753,850, against an aggregate claim of \$6,249,750, or approximately 44 per cent of the face of said claim. Using the same valuation, no other secured creditor is allotted less than 100 per cent of its claim.

VII. Discriminatory and inequitable treatment of petitioner's claim as compared with claims of other secured creditors.

Your petitioner advanced to the debtor company during 1931 and 1932 (during the depression), a total of \$4,999,800. The advances were in cash and enabled the debtor company to complete the Northern California Extension, now a factor of admitted

importance in the earning power of the Company. Your petitioner was given, under Commission [862] authorization, General and Refunding Mortgage bonds of the debtor company as collateral, to the extent of 125 per cent of principal amount of its advances.

At about the same time, functioning under Section 5 of the Reconstruction Finance Corporation Act, the Commission required from the debtor company \$10,750,000 face amount of such General and Refunding Mortgage bonds as *part* collateral for advances by the Reconstruction Finance Corporation aggregating \$2,963,000\* principal amount. In other words, disregarding other substantial collateral, the Reconstruction Finance Corporation now holds under authority of the Commission General and Refunding Mortgage bonds of the debtor, as collateral, to the extent of about 363 per cent of the principal amount of its advances, as compared with the 125 per cent furnished to your petitioner.

Functioning under somewhat similar statutory provisions requiring approval by the Commission of advances to be made to railroads by The Railroad Credit Corporation, from the rate advance fund accumulated in its hands, the Commission similarly required collateral for The Railroad Credit Corporation advances to the debtor, which advances stood

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\* The original principal amount of this loan was \$3,063,000, and the collateral required by the Commission therefore represented approximately 351% of the principal amount of the original loan.

as of January 1, 1939, at \$2,445,610 principal amount, in a ratio considerably in excess of that authorized in the case of advances made by your petitioner.

The monies advanced to the debtor by The Railroad Credit Corporation were used in their entirety to pay unearned interest to the First Mortgage bondholders and interest on equipment trusts. The monies advanced by the Reconstruction Finance Corporation were also used in large part for the payment of interest to First Mortgage [863] bondholders and others, but in part for a portion of the costs of the Northern California Extension and other purposes (see Record, Ex. 36).

While the application of the monies advanced by The Railroad Credit Corporation and the Reconstruction Finance Corporation may well give rise to special equities in favor of The Railroad Credit Corporation and the Reconstruction Finance Corporation as against the First Mortgage bondholders, there is no ground for regarding such advances as having special characteristics entitling them to greater equitable consideration than the advances made almost contemporaneously by your petitioner to build the Northern California Extension.

The Commission has, however, in its Plan of June 21, 1939, treated these three creditors on quite dissimilar bases. The Reconstruction Finance Corporation is regarded, for the purpose of the Plan, on the same basis as if its debt was represented by First Mortgage bonds of the debtor company. This

is on the express ground (See page 9, Report of June 21, 1939) that such treatment is in consideration of the purchase by the Reconstruction Finance Corporation of \$10,000,000 First Mortgage bonds of the reorganized company, the proceeds of which are to be used to pay off the Trustees Certificates, all of which are now held by the Reconstruction Finance Corporation. The new First Mortgage bonds in question are to be an exclusive first lien on property to be transferred to the reorganized company, representing an investment, after application of full depreciation, of upwards of \$120,000,000. On the basis of the present operations of the debtor company, even under depression conditions, it appears probable that the fixed charges on the new First Mortgage bonds will be earned from two and a half to three times during the calendar year 1939. Yet the Commission has provided that, virtually as an underwriting fee for taking this \$10,000,000 of new First Mortgage bonds in payment of an existing debt secured by Trustees Certificates, the Reconstruction Finance Corporation shall have its remaining claim as a secured creditor advanced to a preferred position equal to that of the old First Mortgage bondholders and infinitely superior to that of your petitioner.

The Commission has, in other situations, recorded itself as favoring a public offering of securities. Every consideration of equity would suggest that the new First Mortgage bonds in question first be offered for public bidding and, only in the event

that no responsible purchaser at par or better could be found, should the Reconstruction Finance Corporation be given, as an underwriter; an underwriting fee represented by special treatment of its claim as a secured creditor.

As to The Railroad Credit Corporation, the Commission allots to it, as against its claim of \$2,445,610 principal amount, and \$146,503 of interest thereon, \$154,111 of Income Mortgage 4½ Per Cent Bonds, \$241,681 of 5 Per Cent Preferred Stock and 35,425 shares of Common Stock (being common stock taken at the price of \$62 per share).

The Commission Plan allots to your petitioner, as against its claim of \$4,999,800 principal debt and \$1,249,950 interest, \$163,724 of Income Mortgage 4½ Per Cent Bonds, \$256,756 of 5 Per Cent Preferred Stock, and 37,635 shares of Common Stock without par value.

In other words, the Reconstruction Finance Corporation is to receive, under the Commission Plan, 100 per cent of the principal of its claim in the Income Mortgage bonds and Preferred Stock of the reorganized company, and the accrued interest on its claim in Common Stock at \$57 a share. The Railroad Credit Corporation is to receive slightly over 16 per cent of its principal claim in Income Mortgage bonds [865] and Preferred Stock and the balance of principal and interest in Common Stock at \$62 a share. But your petitioner is to receive only a little over 8 per cent of its principal claim in Income Mortgage bonds and Preferred Stock and, against

the balance of \$5,829,270, 37,635 shares of Common Stock which, at \$62 a share would cover only slightly more than 40 Per Cent of this balance.

While the General and Refunding Mortgage bonds, which are the sole collateral held by your petitioner, and part of the collateral held by the Reconstruction Finance Corporation and The Railroad Credit Corporation, are held in varying ratios, these bonds were authorized by the Commission solely for use as collateral in connection with the advances of the particular creditors concerned. The mere fact that the Commission required such excess collateral to be issued to the Reconstruction Finance Corporation and to The Railroad Credit Corporation as compared with your petitioner, on loans made almost concurrently and for equally meritorious purposes, cannot multiply the actual debt claims of the Reconstruction Finance Corporation or The Railroad Credit Corporation at the expense of your petitioner.

Even though the General and Refunding Mortgage bonds held by the three secured creditors were to be regarded as ordinary and usual collateral furnished by the debtor company (which they clearly are not), your petitioner contends that greater distribution to one creditor than to another in this proceeding could be justified only upon a showing that the value of the property of the debtor in which its creditors claim an interest is less than the total amount of the secured creditors' claims. The Commission has at all times failed to make any apprai-

sal of the value of the property of the debtor company other than its appraisal under Section 19 (a) of the Interstate Commerce [866] Commission Act, which appraisal would indicate that the value of the property of the debtor company is substantially greater than all the debts of the debtor, including not only the claims of the secured creditors, but of the general creditors.

Your petitioner objects that the Commission Plan discriminates unfairly in favor of the Reconstruction Finance Corporation and The Railroad Credit Corporation, does not give due recognition to the rights of your petitioner, and does not conform to the requirements of the law of the land.

VIII. Inequitable treatment of secured creditors generally as compared with holders of First Mortgage Bonds.

All the monies advanced to the debtor by the Reconstruction Finance Corporation, The Railroad Credit Corporation and your petitioner, and now represented by the secured debt obligations of the debtor, were advanced during the depression years and used for the most part (a) to pay unearned interest to the First Mortgage bondholders; (b) to pay taxes and equipment trust obligations which were prior in lien to the First Mortgage bonds; and (c) to provide for the construction of the Northern California Extension, a valuable and essential integral part of the operating railroad property of the debtor.

Your petitioner contends that the General and Refunding Mortgage created by the debtor to provide security for these secured creditors was not subordinated to the lien of the First Mortgage as to all the property of the debtor, but, on the contrary, was intended to give, and did give, a first lien on substantial and essential parts of the operating properties of the debtor and on securities and equipment [867] of the debtor. In this connection reference is made to the objections filed herein by the Irving Trust Company, as substitute trustee of the General and Refunding Mortgage, and to the facts shown by the Record as to the large elements of the property of the debtor on which said General and Refunding Mortgage represents a first lien.

Neither in Section 77 of the Bankruptcy Act nor elsewhere, can be found a delegation to the Commission of the right to dispose of the complicated questions of law involved in the issues as to the conflicting liens of the First Mortgage and the General and Refunding Mortgage. Nor, as a practical matter, is the Commission equipped to decide these questions, which are essentially questions of local law. Section 77 contemplates that these questions should be decided by the Court. Yet the Commission has attempted to determine upon what assets the First Mortgage is a primary lien and upon what assets the General and Refunding Mortgage is a primary lien.

Your petitioner objects that the Commission, in determining the issues as to the conflicting liens of

the First Mortgage and the General and Refunding Mortgage, has received and relied upon incompetent evidence and has arrived at conclusions which are erroneous in law and unsupported by evidence. Your petitioner insists that the property of the debtor which is subject to the lien of the General and Refunding Mortgage but free from the First Mortgage of the debtor is sufficient in value to fully secure the debts of your petitioner and the other two secured creditors. In this connection your petitioner concurs in the objections filed herein by the Irving Trust Company, as substitute trustee under the General and Refunding Mortgage. [868]

Your petitioner contends that the Commission Plan should be modified so as to accord to The Railroad Credit Corporation, as well as to your petitioner, the same treatment that is accorded under the Plan to the holders of the existing First Mortgage bonds and to the Reconstruction Finance Corporation.

IX. Confiscatory and inequitable treatment of general creditors and equity under Commission Plan.

The Commission Plan not only fails to provide for more than approximately 44 per cent of the claim of your petitioner as a secured creditor, but expressly finds that the general creditors and stockholders of the debtor have no "interest" in the property. This finding is not based on any factual evidence presented to the Commission in the hearings

before its examiners, but upon the theory that the capitalization should be based solely upon a mere estimate of future earnings, made by the Commission's Bureau of Finance. No basis for this procedure can be found within the four corners of Section 77, nor is it sustained by the law of the land. The application of this theory, if approved and confirmed, would not only work substantial injustice to secured creditors, general creditors and the equity owners of this property, but would, if applied generally, be substantially prejudicial to the whole future of the railroad industry.

The Commission does not, in either its Report of October 10, 1938, or its Report of June 21, 1939, make any new determination of the value of the property to be taken over by the reorganized company. It does refer to, and apparently adopts, its valuation of the property of the debtor company, made by the Commission under Section 19 (a) of the Interstate Commerce Commission Act, which amounted, with allowances for "the net costs of additions and [869] retirements" to December 31, 1935, to \$139,600,455. (Report of October 10, 1938, pages 24-25).

It is not denied that the depreciated investment in the property of the debtor company would amount to upwards of \$120,000,000 (Record, Ex. 29, Statement 16, page 2; see also opinion of Commissioner Miller, Report of October 10, 1938, page 73).

The total debts running against the debtor, including the outstanding equipment trusts and leases, Trustees Certificates, First Mortgage bonds, claims

of the secured creditors and claims of the general creditors, with interest in all cases accrued to January 1, 1939, amounted in the aggregate to \$95,699,502.

Your petitioner contends that the depreciated investment in the property used or useful in the public service should be, under the law of the land and the requirement of equitable treatment of the various interests in the property, the primary measure in determining the limits of the capital structure of the reorganized company, and that any drastic reduction in such capitalization based solely on the present reduced earnings of the enterprise in an attempt to assure dividends on the common stock of the reorganized company is inequitable and without support in law.

The effect of the Commission Plan is to transfer to other creditors of the debtor part of the interest which your petitioner has in the property of the debtor as a creditor and the entire interest in the property of the debtor which the general creditors of the debtor (The Western Pacific Railroad Corporation and Western Realty Company) have, as well as all of the interest represented by the stock of the debtor company, all of which is held by The Western Pacific Railroad Corporation. [870]

It is contended by your petitioner that not only do the secured creditors and the general creditors have a real and substantial "interest" in the property of the debtor company, but the stockholders have a like interest. These interests of the general creditors and stockholders might, of course, be ter-

minated, because of the recent inability of the property to earn its fixed charges, by foreclosure of the respective liens of the First Mortgage and General and Refunding Mortgage. But in a reorganization under Section 77 of the Bankruptcy Act creditors are entitled to insist that fair values, and not forced sale values, should be used in determining the capitalization of the reorganized company and the securities to be given each class of creditors.

This principle is recognized in the brief of the United States, *amicus curiae*, which was largely relied upon by the United States Supreme Court in *Case v. Los Angeles Lumber Products Company*, decided November 6, 1939 (84 L. Ed. 22), at pages 16 and 17 of the brief:

"In cases of liquidation no one questions the right of senior security holders to full payment before any distribution of assets to junior interests. Reorganization is an alternative for liquidation in the event of financial failure. It seeks to substitute going concern values for the forced sale values of liquidation, with the object of yielding greater ultimate returns to the senior interests, and allowing wider participation if the values permit. But it presents no occasion or excuse for a different treatment of priorities in disregard of senior contract rights.

\* \* \*

See also

First National Bank of Cincinnati v. Fler-shem, 290 U. S. 504;

In re Dutch Woodcraft Shops, 14 Fed. Supp. 467. [871]

The Commission is empowered under Section 77 to determine the value of the property of the debtor and certify the same to the Court for its approval, and, in determining such value, the Commission is empowered to give due consideration to the earning power of the property, but, expressly, it must give that effect to "the present cost of reproduction new, and less depreciation, and original cost of the property and the actual investment therein as may be required under the law of the land."

Your petitioner respectfully submits that under the established law of the land no interest of a creditor or stockholder can be disregarded in the formulation of a plan of reorganization under Section 77, except on the basis of an appraisal of the property. In this case the Commission has made no appraisal except its undisputed appraisal under Section 19 (a) of the Interstate Commerce Commission Act, on the basis of which the general creditors and the equity owners all have a substantial interest in the property of the debtor.

For the reasons above stated your petitioner has throughout the proceedings before the Commission and in the plan which it submitted to the Commission for consideration, consistently urged that no

plan of reorganization of the debtor company can be held to be fair or equitable, consonant with the purposes of Section 77 and consistent with the law of the land, unless recognition is given to the interests of the general creditors and the equity owners, and, further, that such recognition should be determined primarily on the basis of the actual investment in the property, less accrued depreciation. [872]

X. Capitalization theory of the Commission fallacious and without support in law.

The basic fallacy in the Commission Plan lies in its drastic and unnecessary wiping out of private rights in an unrealistic adherence to a mere theory of capitalization, which theory of capitalization finds no support in the language of Section 77 or elsewhere.

The Commission spells out its theory for partially or entirely disregarding substantial interests in the property in its Report of October 10, 1938, which is referred to and adopted in its Report of June 21, 1939 (See page 7, Report, June 21, 1939).

The Report of October 10, 1938, (page 40) states that Section 77 of the Bankruptcy Act provides that an approved plan should be "compatible with the public interest". It states that "public interest is not defined", but interprets the phrase to require, among other things, "that the capitalization should not exceed a conservative appraisal of the assets to be taken over by the reorganized company.

and that proposed charges, whether fixed or contingent, be within its probable earning power."

Without regard to logical connection, the Commission proceeds to state, on page 41 of its Report of October 10, 1938, what it apparently deems to be a corollary to the foregoing proposition, to the effect that consideration should be given to the investment in the property of the debtor company "only to the extent that such investment is justified by probable earnings reasonably foreseeable for the future."

Having thus touched lightly on the question of investment in the property, the Commission then moves forward to the conclusion that it ought not to authorize a capital [873] structure for the reorganized company which includes capital stock on which dividends are not reasonably likely to be paid. At pages 51-52 of its Report of October 10, 1938, the Commission states:

"the capitalization of the reorganized company must be maintained within strict limits if any material return on its capital stock is to be expected and the shares of its stock are not to become mere tokens for stock market speculation. It is true that considered alone, the data pertaining to the rate-making value of the debtor's property, and its investment, would support capitalizations approximating those proposed in the three plans" (those proposed by the parties to the proceeding). "We have hereinbefore stated, however, the reasons why,

in our opinion, those factors can not be of controlling importance in a determination of the capital structure for the reorganized company," (apparently referring to its argument as summarized above).

The Commission has never tried to explain further why its theory that a material return should be assured or expected on the capital stock of the reorganized company should, "in the public interest", take the place of "a conservative appraisal of the assets to be taken over by the reorganized company", to which the Commission refers on page 40 of its Report of October 10, 1938. Any justification that might be grounded on the argument that, if common stock of the reorganized company pays immediate dividends, it may prove a channel for future financing is completely negated by the fact that the operation of the Commission theory at the present time is to disregard the substantial rights of secured creditors, general creditors and stockholders in the property and, in effect, to confiscate these rights on the basis of a mere theory of capitalization. No one thing could more clearly and certainly destroy common [874] stock as a vehicle for future financing of railroad properties than this proposed action of the Commission.

At a hearing before the Special Subcommittee on Bankruptcy and Reorganization of the Committee on the Judiciary of the House of Representatives,

on June 21, 1939, Chairman Eastman of the Interstate Commerce Commission stated:

"Any estimate of the future earnings of a railroad can at best be no more than an 'educated guess', but there has never been a time in the history of the country when it has been more difficult to make such a guess than now. Anything remotely approaching accuracy is impossible."

At a later point in his testimony he stated:

"To deprive thousands of investors who in the past have put their savings into railroad securities of all hope of recoupment is a very serious step, for if our capitalistic society is to succeed, it demands as scrupulously fair treatment of investors as of labor."

While Section 77 gives the Commission the express power to limit fixed charges provided by a plan which comes before it, there is nowhere in Section 77 such express power vested in the Commission to limit the total capitalization of the reorganized enterprise solely to insure that dividends will be paid on the capital stock which it authorizes. Even more clearly it may be asserted that there is complete absence of power given to the Commission to declare the interest of a creditor of the debtor without value solely on the basis of such a theory of capitalization.

Your petitioner contends that Section 77 of the Bankruptcy Act is not a condemnation statute and

objects that the Commission's theory of capitalization results in dis- [875] crimination as between the various classes of investors in the property, including your petitioner; and results in confiscation of the legal and equitable claims of unsecured creditors and stockholders, all of which is contrary to the law of the land.

XI. Special factors affecting future earnings of this property not given adequate weight by Commission.

In addition to the general objection which may fairly be urged to the cutting off of existing property rights and interests on the basis of a mere estimate of future earnings, there are special factors existing as to this property which render the Commission procedure particularly unfair and inequitable.

The Commission estimate of future earnings is based upon an examination of the earnings record of the property during recent years. The Commission estimate is substantially less than the estimates of the management as to future earnings, which appear in the record before the Commission.

Three special factors exist which render the earnings record of this particular property for the past ten or twelve years an unsatisfactory guide or spring-board for an estimate of future earnings.

When new investment came into the stock of this property some twelve years ago, the management soon found that the property required substantial

improvement and rehabilitation for efficient operation. All dividends were immediately stopped and a program of improvement and rehabilitation promptly started. When this program was interrupted by the 1929 depression, approximately \$8,000,000 had been spent, of which, under Commission accounting [876] rules, almost half was charged as operating expense. When the property came into trusteeship the improvement program was resumed. \$10,000,000 was borrowed upon Trustee Certificates with the approval of the Court and this money expended to complete the program. Of the \$10,000,000 so spent in 1936, 1937 and 1938, almost half was, under Commission accounting rules, charged as operating expenses.

The substantial effect of the termination of these special charges and the completion of the Rehabilitation Program on the earnings position of the debtor is evidenced by the fact that in the first nine months of 1939, while "Total Railway Operating Revenues" increased only \$1,728,278.89 over the corresponding period of 1938, "Net Revenue from Railway Operations" increased by \$2,473,531.51; That is, from a deficit of \$656,594.23 in 1938 to an actual net of \$1,816,937.28, in 1939.

Moreover, in 1931 and 1932, the Company built its Northern California Extension, a connection with the Great Northern Railway, which cost approximately \$10,000,000. This addition has already resulted in an enormous improvement in the traffic

position of the property and has a large and, as yet, not fully measured relationship to the future earnings of the property. While this Northern California Extension was under construction, however, and while it was becoming seasoned as a channel for traffic, there was, of necessity, an additional and substantial burden of expense thrown upon the property, which necessarily distorted its earnings figures.

The third special factor having to do with the earnings record of the debtor is that during the depression there was put into operation the so-called Dotsero Cut-off on the Denver and Rio Grande lines, which greatly improved the facilities for traffic moving over the Western Pacific [877] through the Denver gateway and which, it is believed, will ultimately have an important and beneficial effect on the net earnings of the debtor property.

By reason of these special factors and general business conditions, progressive improvement in the earnings of the debtor's property is indicated.

Moreover, in recent months there have been substantial increases in traffic over the debtor lines, and over the lines of other carriers similarly situated. It is difficult, at the present time to adequately estimate the possible scope and extent of such traffic improvement, which has resulted in part from the impact of a general European war. Any estimate of railroad earnings made prior to the development of war conditions must be revised.

Terminating existing property rights and interests in the debtor on the basis of future earnings estimates based on the experience of the past ten or twelve years, in view of the factors set forth above, is clearly inequitable and prejudicial to the rights of creditors and stockholders.

XII. Objection to funding of accrued interest in common stock so as to give present First Mortgage bondholders control of the reorganized company.

The Commission Plan proposes to give to the First Mortgage bondholders 40 per cent of their principal claim in Income Mortgage 4½ per Cent Bonds and 60 per cent of the principal amount of their claims in 5 Per Cent Preferred Stock. This Preferred Stock carries a participating feature which entitles the Preferred Stock, after receiving its 5 per cent dividend, to share equally with Common Stock in all distributed earnings of the enterprise after \$3.00 per share per year have been paid on the Common Stock. [878]

The Commission then proposes to distribute to the First Mortgage bondholders, against interest accumulated since January, 1934, amounting to \$13,143,777 (for the most part unearned by the debtor company during that period) securities for 100 per cent of this accrued and unpaid interest in the form of Common Stock taken at the price of \$57.00 a share. This common stock to be issued to

the First Mortgage bondholders for accrued and unpaid interest would amount to 230,593 shares of Common Stock out of the total Common Stock authorized for the reorganized company of 319,441 shares; or more than 72 per cent of such total issue.

When the Western Pacific Railway Company, a predecessor company owning this property, was reorganized in 1916 the then existing debt to the First Mortgage bondholders was paid off in preferred and common stock of The Western Pacific Railroad Corporation, organized to hold all the stock of The Western Pacific Railroad Company, a new corporation organized to continue the operations of the railroad. As is the case at the present time, a large part of the mortgage debt of the predecessor company, the Western Pacific Railway Company, was held in 1916 by insurance companies and fiduciaries who were under legal compulsion to sell the stock so received within a reasonable time after it was received in exchange for the bonds previously held. In the case of the insurance companies, it was possible in most instances for them to obtain from the Superintendents of Insurance in the various states extension of time in which to sell such stock.

Complete control of the operations of the new enterprise was, by the method of reorganization adopted, vested in the prior bondholders, who had become involuntary stockholders. During the period from 1917 to 1927 approxi- [879] mately \$18,000,000 was paid out in dividends to the preferred and com-

mon stockholders, as indicated by the following table:

Year	Common or Preferred	Dividend Paid
1917	Preferred	\$ 2,062,500
1918	None	—
1919	Preferred	825,000
1920	Preferred	1,925,000
1921	Preferred	1,650,000
1922	Preferred	1,650,000
1923	Preferred	1,650,000
1924	Preferred	1,650,000
1925	Common—	\$2,374,970
	Preferred	2,078,450
1926	Preferred	1,650,000
1927	Preferred	412,500
1928 to		
1938	None	
Total		\$17,928,420

When, in 1926 and 1927, interests affiliated with your petitioner acquired a substantial interest (upwards of 40 per cent) in the preferred and common stock of The Western Pacific Railroad Company, a survey was promptly made of the operating property. This survey disclosed that the expenditure of approximately \$18,000,000 would be required to rehabilitate the operating property and to make additions and betterments necessary to put it in first class operating condition. Dividends on the stock were immediately discontinued and an improvement and rehabilitation program commenced. From 1927 up to the interruption of the program

in the 1929 depression approximately \$8,000,000 was spent upon this program. The program was renewed in 1936 under the supervision of this Court, and the balance of approximately \$10,000,000 was spent in 1936, 1937 and 1938 to complete the rehabilitation [880] program. Almost half of these expenditures were deferred maintenance charges, and were necessarily so treated under Commission accounting rules, and do not appear as capital items in the Commission's appraisal under Section 19 (a) of the Interstate Commerce Commission Act or in the investment account of the property of the debtor, elsewhere referred to in this statement.

Your petitioner contends that it is theoretically unsound, and has been demonstrated by experience in connection with this particular property to be unsound in practice, to put actual control of a railroad enterprise in the hands of those who have involuntarily become owners of equity stock and are under legal compulsion to market such stock within a reasonable period after its receipt by them. It is objected that, to the extent that interest is properly to be funded for the benefit of the First Mortgage bondholders, it should be funded in the same type of securities issued to them for their principal debt.

XIII. Commission Plan allows excessive accrued interest to Reconstruction Finance Corporation.

The Commission Plan proceeds on the theory that the Reconstruction Finance Corporation is entitled,

as of January 1, 1939, to accrued interest amounting to \$899,870, which result apparently flows from the application of a straight 6% rate per annum to the principal debt to the Reconstruction Finance Corporation. The amount of interest actually due on January 1, 1939, to Reconstruction Finance Corporation, based on various authorized modifications of the 6% rate for various periods, as shown by the books of the debtor, is \$723,864 (Record, Ex. 36). [881]

XIV. Commission Plan discriminates in favor of The Railroad Credit Corporation by permitting it to retain, after reorganization, debtor's interest in marshalling and distributing plan of 1931.

Under Subdivision (R) of the Commission's Order of June 21, 1939, The Railroad Credit Corporation is expressly authorized to retain, after the reorganization, all sums which may accrue upon the debtor's interest under the marshalling and distributing plan of 1931, although all other secured creditors are required to surrender their entire collateral. This preferential treatment of The Railroad Credit Corporation is inequitable and discriminatory as to your petitioner.

XV. Commission Plan imposes unnecessary limitations upon management through provision for mandatory rather than discretionary capital fund.

The Commission Plan provides (Order of June 21, 1939, Subdivision (L) Pages 17-18) for a com-

pulsory capital fund at the rate of \$500,000 per year as a deduction from income. Under the capital structure proposed by the Commission no party to the proceeding could properly object to a discretionary capital fund in the amount stated. The past history of this property, to which reference is hereinabove made, emphasizes the importance of full provision for maintenance expenditures, even though necessarily chargeable to capital in part, before distribution of earnings to the investor. The attention of the Court is, however, directed to the objections to a compulsory capital fund, as distinct from a permissive capital fund, as well expressed by Chairman Eastman of the Interstate Commerce Commission in his dissenting opinions in this proceeding and in the Spokane International Railway Company Reorgani- [882] zation, 230 Interstate Commerce Commission 81, 107. Your petitioner urges that the provision for a capital fund be modified to provide that such capital fund be a matter of managerial discretion within the limits specified by the Commission Order.

XVI. Sinking fund provisions of Commission Plan unnecessarily burdensome.

The Commission Plan provides for no sinking fund upon the proposed new First Mortgage bonds, unless and until the amount of new First Mortgage bonds outstanding be doubled, as compared with the amount presently to be issued.

It provides, on the contrary, that an immediate sinking fund, at the rate of  $\frac{1}{2}$  per cent of principal amount annually, be created as to the proposed Income Bonds to be issued to the present First Mortgage bondholders.

Your petitioner agrees that there is no need for a requirement of the present amortization of a fixed interest debt of only \$10,000,000 on a railroad property representing an investment, less depreciation, of upwards of \$120,000,000.

On the other hand, your petitioner objects that there is no necessity or justification for a provision that the Income Bonds be amortized. The effect of this sinking fund provision will necessarily be to reduce the possibility that the reorganized company will be able to finance its future needs by the marketing of additional preferred or common stock to meet future capital needs. The capital represented by existing First Mortgage bonds must necessarily be regarded as a permanent investment in the enterprise. Its gradual retirement from [883] earnings is not, as a practical matter, a feasible objective. The disadvantages to the reorganized company which will flow from any such impairment of the marketability of its capital stock issues far outweighs the advantage to the holders of the income bonds of a small sinking fund provision.

These considerations have especial weight in view of the fact that, as a matter of common knowledge, a substantial part of the present First Mortgage Bonds are held by institutions or trustees, who will

be compelled ultimately to dispose of any capital stock which they may receive in the reorganization, but will be permitted to continue to hold the income bonds received. Anything that militates against the marketability of the preferred stock to be issued to present First Mortgage bondholders in the reorganization will be definitely prejudicial to the position of those First Mortgage bondholders who find it necessary to market their preferred stock within a reasonable period of time after receipt thereof.

XVII. Division under Commission Plan of Securities as between Income Bonds and Preferred Stock unnecessarily burdensome to creditors. \*

On the same grounds set forth in the preceding paragraph, your petitioner contends that the Commission Plan is defective in allotting to existing First Mortgage bondholders 40 per cent of income bonds and 60 per cent of preferred stock. Since the bonds are income obligations, no future default on the part of the reorganized company will flow from a failure to meet interest payments on the income bonds, if such interest is unearned, any more than it will from a failure to declare dividends. The Income Bonds, as provided in the Commission Plan, will not mature until [884] January 1, 2014. It is true that one may theoretically consider the contingency of providing for the maturity of these income bonds sixty-five years from the date of issue, while, in the case of preferred stock, no such contingency arises, yet this is a somewhat theoretical

basis on which to narrowly limit the proportion of income bonds which shall be issued in lieu of the existing First Mortgage bonds.

In the plan which your petitioner submitted to the Interstate Commerce Commission it was expressly provided, for the reasons hereinbefore set forth, that the entire First Mortgage debt should be retained in the form of debt on an income basis. Your petitioner still feels that that position is sound and in the substantial interest of a large class of present First Mortgage bondholders.

Your petitioner objects to the allocation proposed by the Commission and contends that at least 50 per cent of the existing First Mortgage debt should be refunded into income bonds and the remaining 50 per cent into preferred stock.

#### XVIII. Objection to interest rate for Income Bonds provided by Commission Plan.

In the original Commission Plan, as promulgated by its order of October 10, 1938, the Income Bonds were to carry interest at 4%. This was a realistic recognition of the present prevailing level of interest rates generally. At the rehearing before the Commission, upon motions made by the various parties, counsel for the Insurance Company Committee strongly urged an increase in this rate to 4½%, and this request was granted by the Commission in the modifications in its plan provided under its order of June 21, 1939. [885]

The maintenance of the 4 per cent interest rate on the proposed Income Bonds would improve the status of the preferred stock and common stock without corresponding detriment to those creditors who are given Income Bonds under the Commission Plan. So far as the present First Mortgage bondholders are concerned, any such reduction of the interest rate on the new Income Bonds, would be subject to possible recoupment in part through the participating feature of the preferred stock, issued to them for a substantial part of their claims, while the credit of the enterprise generally would be helped by the resulting reduction of contingent charges.

XIX. Alternative organization of new corporation contemplated by Commission Plan is unnecessarily expensive and burdensome.

The Commission Plan, Subdivision (R) Order of June 21, 1939, authorizes the reorganization committee, constituted under the Plan, to organize a new corporation to take over the properties of the debtor, or to recapitalize the debtor corporation, in its discretion. Whatever might be the merits of the organization of a new corporation under the old processes of equity reorganization, your petitioner submits that Section 77 permits and contemplates the substantial economies which will flow from the retention of the present corporate structure of the debtor, and its recapitalization to effect its reorgan-

ization pursuant to such plan as may ultimately be approved.

XX. Plea to the Court for correction of defects in Commission Plan.

Your petitioner is advised and believes that if this Court shall remove, or cause to be removed, by its recommendation to the Commission of appropriate amendments [886] to the Commission Plan, the defects in said Commission Plan, which are set forth above, such proposed Amended Plan would meet with the approval of the statutory percentage of each class of creditor and stockholder of the debtor. Moreover, the amendments necessary to remove such objections would not change the capital structure proposed under the Commission Plan for the reorganized company so as to increase fixed charges, or so substantially increase other securities, as to render such proposed Amended Plan fairly open to any finding by the Commission that it was not in the public interest.

There is set out below a comparison of the capital structure proposed under the Commission Plan and that which would exist under the amendments now proposed by your petitioner in Article XXII of this statement, as hereinafter set forth, to correct the defects set out above.

## CAPITAL STRUCTURE OF REORGANIZED COMPANY

	Under Commission Plan	Under Proposed Amendments Thereof
Undisturbed Equipment Trusts and Leases	\$ 2,750,050	\$ 2,750,050
New First Mortgage 4% Bonds	10,000,000	10,000,000
New Income Mortgage 4% Bonds	21,219,875	37,481,302
New 5% Participating Preferred Stock	\$1,850,297	37,481,302
New Common Stock without par value	319,441	319,441

Under the proposed Amended Plan the present First Mortgage bondholders would have approximately 45 per cent. of the voting power in the reorganized company and receive approximately 45 per cent. of the equity earnings of the reorganized company after the payment of their Preferred Stock dividends and the payment of \$3.00 a share on the Common Stock. [887]

## XXI. Procedure for correction of Commission Plan.

The procedure contemplated by Section 77, where substantial amendments in a plan reported by the Commission seem to the Court to be necessary to meet the equitable claims of the parties and to conform such plan to the law of the land, is that the Court refer back to the Commission the Plan with recommendations for modifications, which recom-

mendations will, no doubt, be promptly accepted by the Commission. (See Louisiana and North West Railroad Company Reorganization, 230 F. C. C. 171.)

At a hearing before the Special Subcommittee on Bankruptcy and Reorganization of the Committee on the Judiciary of the House of Representatives, on June 21, 1939, Honorable Joseph B. Eastman, now Chairman of the Interstate Commerce Commission, approved this procedure. In discussing a legislative proposal for the amendment of Section 77 of the Bankruptcy Act, Mr. Eastman said:

"However, in most of the important reorganization cases now pending before the Commission the record has already been made, and the time thus consumed cannot now be saved. Any conclusions that the Commission may reach in these cases as to respective liens and priorities will be helpful to the judge as the equivalent of a report by a master, and the Commission will readily respond to adjustments of the plan to any different conclusions he may reach as to such matters."

#### XXII. Specific amendments proposed to Commission Plan.

Your petitioner respectfully requests that the Commission Plan be referred back to the Commission, for modification so as to cure the defects set forth above, and by specifically modifying the Commission Plan as follows: [888]

(1) Amending Subdivision (B) of the Commission Plan, as it appears on page 2 of the Commission Order of June 21, 1939, by increasing the amount of new Income Mortgage  $4\frac{1}{2}\%$  Bonds from \$21,219,075 to \$37,481,302 and decreasing the rate for said bonds from  $4\frac{1}{2}\%$  to 4%; increasing the amount of new 5% Preferred Stock from \$31,850,297 to \$37,481,302.

(2) Amending Subdivision (J) of the Commission Plan, as it appears at pages 10 and 11, Order of June 21, 1939, so as to provide that the amount of such Income Mortgage Bonds, Series A, shall be \$37,481,302, instead of \$21,219,075 and that the rate upon such Bonds shall be 4%, instead of  $4\frac{1}{2}\%$ ; eliminating the provision for a sinking fund which appears as the next to last paragraph of Subdivision (J) on pages 12 and 13 of the Order of the Commission of June 21, 1939.

(3) Amending Subdivision (L) of the Commission Plan, as to the second numbered paragraph on page 17, Order of June 21, 1939, by inserting, after the word "creation" in the first line of the said paragraph number two, the phrase, "in the discretion of the board of directors of the reorganized company"; and amending the language of sub-paragraph (a) of said numbered paragraph two, appearing on page 18 of the Order of the Commission of June 21, 1939, by inserting in the second line

thereof, in lieu of the word "be" which appears as the fourth word in that line, the words "not be more than".

(4) Amending Subdivision (L) of said Commission Plan, at page 19 of the Order of June 21, 1939, by striking out numbered paragraphs 4 and 5 as to the sinking fund on Income Mortgage Bonds and renumbering the remaining paragraphs on that page.

(5) Amending Subdivision (M) of the Commission Plan, at page 20, Order of June 21, 1939, by providing that 374,813  $\frac{2}{100}$  shares of Preferred Stock, Series [889] A, are to be issued in the reorganization in lieu of 318,502  $\frac{97}{100}$  shares.

(6) Amending Subdivision (N) of the Commission Plan at page 24, Order of June 21, 1939, by providing that 1,100,000 shares of Common Stock without par value, will be authorized instead of 1,000,000 shares, as therein set forth; and that 749,626 shares shall be reserved for Income Mortgage Bonds, Series A, instead of 424,382, as therein set forth.

(7) Amending Subdivision (O) of the Commission Plan appearing at pages 24 and 25 of the Commission Order of June 21, 1939, so as to read as follows:

"The ten million dollars First Mortgage Bonds, Series A, shall be offered at public bidding, and sold at the best price obtainable, but not less than the face amount plus ac-

crued interest thereon. In the event no bid is received of at least the face amount plus accrued interest for said bonds, said bonds shall be sold at their face amount plus accrued interest, to Reconstruction Finance Corporation, subject to the approval of the Commission of such purchase in a separate proceeding, and in such event such reasonable underwriting fee as may be fixed by the Commission in said proceeding shall be paid by the reorganized company to Reconstruction Finance Corporation."

(8) Amending Subdivision (P) of the Commission Plan, appearing on page 25 to 27 of the Commission Order of June 21, 1939, to read as follows:

"P. The existing securities of the debtor shall be treated as follows:

"T. Existing equipment trusts, Baldwin lease, and Pullman contract, aggregating \$2,750,050 shall remain undisturbed and shall be assumed by the reorganized company.

[890]

"2. Holders of existing First Mortgage bonds shall receive for each \$1,000 of indebtedness, including interest accrued to January 1, 1939, \$500 of new Income Mortgage 4 Per Cent Bonds, Series A, and \$500 of 5 Per Cent Participating Preferred Stock, Series A.

"3. Reconstruction Finance Corporation shall receive for its existing claim of \$3,686,-

864, which includes accrued interest to January 1, 1939, \$1,843,432 of new Income Mortgage 4 Per Cent Bonds, Series A, and \$1,843,432 of 5 Per Cent Participating Preferred Stock, Series A.

"4. The Railroad Credit Corporation shall receive for its existing claim of \$2,592,113, which includes accrued interest to January 1, 1939, \$1,296,056.50 of new Income Mortgage 4% Bonds, Series A, and \$1,296,056.50 of 5% Participating Preferred Stock, Series A. This provision is subject to the reduction of said amounts, pro rata, by the application, prior to the date of actual issue of the new securities under the plan, of any proceeds from the distributive shares of the debtor or its subsidiaries, under the marshalling and distributing plan, 1931. Adjustment in cash for fractional shares or fractional parts of the smallest denomination of the new Income Mortgage 4% Bonds, Series A, shall be made.

"5. A. C. James/Co. shall receive for its existing claim of \$6,249,750, which includes interest accrued to January 1, 1939, \$3,124,875 of new Income Mortgage 4% Bonds, Series A, and \$3,124,875 of 5% Participating Preferred Stock, Series A.

"6. Western Realty Company shall receive for its unsecured claim of \$61,667, which includes interest accrued to January 1,

1939, 617 shares of Common Stock without par value. [891]

"7. The Western Pacific Railroad Corporation shall receive for its unsecured claim of \$7,749,175, 77,492 shares of Common Stock without par value.

"8. The Western Pacific Railroad Corporation shall receive for its holding of \$28,300,000 in Preferred Stock and \$47,500,000 in Common Stock of the debtor (being all the outstanding stock of each class) 241,332 shares of Common Stock without par value."

(9) Amending Subdivision (R) of the Commission Plan, appearing on pages 29 and 30 of the Commission Order of June 21, 1939, (a) by striking out the exception in the second paragraph of said Subdivision (R) which would permit The Railroad Credit Corporation to retain for its own benefit the proceeds of the distributive shares of the debtor and its subsidiaries under the marshalling and distributing plan, 1931, after the effective date of the Plan; (b) by providing that the Reorganization Committee shall consist of five persons, all to be approved by the Court, who shall be designated, one by the Insurance Company Committee, one by the Reconstruction Finance Corporation, one by The Railroad Credit Corporation, one by your petitioner, and one by The Western Pacific Railroad Corporation; and (c) by providing expressly that the reorganiza-

tion shall be carried out by the recapitalization of the debtor, rather than by the organization of a new corporation.

Wherefore your petitioner respectfully prays:

(a) That this Court return to the Commission, the Commission Plan with the recommendation that it be amended in the various respects specifically set out in Article XXII above; and [892]

(b) That, unless said Plan be so amended and corrected, said Commission Plan be disapproved as discriminatory and unfair and inequitable to your petitioner and to other parties in interest and not in conformity with the law of the land;

And for such other and further relief as to the Court may seem just and proper.

Dated: December 8, 1939.

A. C. JAMES CO.,

By W. W. CARMAN,

Vice President and Treasurer.

WHITMAN, RANSOM, COULSON & GOETZ,  
ROBERT E. COULSON,  
HORACE E. WHITESIDE,

40 Wall Street,

New York, New York.

GARRET W. McENERNEY and  
ANDREW F. BURKE,

2002 Hobart Building,

San Francisco, California.

Attorneys for Objector and Petitioner. [893]

State of New York,

County of New York—ss.

W. W. Carman, being first duly sworn, deposes as follows:

I am an officer, to wit, the Vice-President and Treasurer of A. C. James Co., the objector and petitioner named in the foregoing Objections and Petition, and am duly authorized to make this affidavit and verify said Objections and Petition; I have read said Objections and Petition and know the contents thereof; the same are true of my own knowledge except as to matters therein stated on information and belief, and as to those matters I believe the same to be true.

W. W. CARMAN.

Subscribed and sworn to before me this 4th day of December, 1939.

JAMES YUTLE,

Notary Public, Westchester County.

Certificate filed in New York County.

New York County Clerk's No. 73.

New York County Register's No. 1 Y 39.

Commission expires March 30, 1941.

[Endorsed]: Filed Dec. 8, 1939. [894]

[Title of District Court and Cause.]

OBJECTIONS OF THE WESTERN PACIFIC  
RAILROAD CORPORATION TO COMMIS-  
SION PLAN OF REORGANIZATION,  
STATEMENT OF CLAIMS FOR EQUIT-  
ABLE TREATMENT, AND PETITION  
FOR AMENDMENT OF SUCH PLAN.

The Western Pacific Railroad Corporation (hereinafter designated "Corporation"), an unsecured creditor of the debtor, and owner and holder of all the issued and outstanding capital stock of the debtor, hereby objects to the modified Plan of Reorganization of the ~~debtor~~ (hereinafter designated the "Commission Plan"), approved by the Interstate Commerce Commission (hereinafter designated the "Commission") and certified to this Court, and presents its claims for equitable treatment, pursuant to the provisions of subdivision (e) of Section 77 of the Bankruptcy Act, as amended, and to the order of this Court filed herein November 8, 1939.

The Corporation's objections, generally stated, are that said Commission Plan is unfair and inequitable as to the Corporation; does not afford due recognition to the rights of unsecured creditors and stockholders of the debtor, discriminates unfairly in favor of certain classes of secured creditors, does not conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders as required by subdivision (e) of Section 77, and that said Section

77, as [896] interpreted and applied by the Commission, is invalid in that it deprives the Corporation of its property and of its interest in the property of the debtor without compensation and without due process of law, contrary to the provisions of the Fifth Amendment to the Constitution of the United States.

For a more detailed statement of said objections and of the claims of the Corporation for equitable treatment the Corporation represents to the Court and petitions as follows:

I. The Corporation's Claim as Unsecured Creditor.

The Corporation (a corporation organized under the laws of the State of Delaware) is an unsecured creditor of the debtor in the principal amount of \$5,768,746. Interest accrued thereon to January 1, 1939 amounts to \$1,980,429, making a total claim for principal and interest to January 1, 1939 of \$7,749,175.

The indebtedness represents advances on open account, advanced by the Corporation to the debtor from time to time before the institution of the reorganization proceedings.

The Western Realty Company, a Colorado corporation, is an unsecured creditor of the debtor, its claim amounting to \$50,000 principal with interest to January 1, 1939 of \$11,667, a total of \$61,667.

A proof of claim was duly filed by the Corporation in the above entitled proceedings for reorgan-

ization of the debtor. A similar proof of claim was likewise filed by The Western Realty Company.

By an order entered August 20, 1935 this Court classified the above described claim of the Corporation and the claim of The Western Realty Company as separate and distinct classes for the purposes of Section 77 of the Bankruptcy Act, as amended. The Corporation's claim was by such order classified as Class 10 and the claim of The Western Realty Company as Class 11. [897]

II. The Corporation's position as owner of the equity in the debtor's property.

The Corporation is the owner of all the outstanding stock of the debtor consisting of \$28,300,000 par value of preferred stock and \$47,500,000 par value of common stock. By the said order of August 20, 1935 the preferred stock was classified as Class 12 and the common stock as Class 13.

All of said stock, preferred and common, was issued in 1916, in connection with the reorganization of the predecessor company of the debtor and was issued in exchange for first mortgage bonds of said predecessor then outstanding. Said first mortgage bonds of said predecessor company represented money actually paid to said predecessor and used by it for capital expenditures in the construction, equipment and maintenance of the railroad properties.

The ultimate beneficial ownership of the unsecured claim against the debtor, and of the stock of

the debtor, owned by the Corporation, resides in the stockholders of the Corporation who are many thousands in number.

III. The Commission's treatment of the Corporation's claim as a general creditor and as sole stockholder of the debtor.

The Commission Plan makes no provision whatever for recognition of the unsecured claim of the Corporation (or of The Western Realty Company).

It makes no provision whatever for recognition of the equity of the Corporation as the owner and holder of all the outstanding stock, preferred and common, of the debtor.

IV. ~~Objections of Corporation to Commission Plan.~~

Conceding that secured claims are entitled to full protection out of the assets of the debtor before unsecured claims, and that unsecured claims are entitled to like recognition in priority to stockholders, the Corporation's position is that there is no justification under Section 77 of the [898] Bankruptcy Act or under the law of the land for destroying or confiscating either the claims of general creditors or the equity of stockholders, unless the debtor is insolvent in the bankruptcy sense, that is, unless the aggregate of its property "shall not at a fair valuation be sufficient in amount to pay his (its) debts" (Bankruptcy Act, as amended, Section 1(19).)

(a) The Commission did not find that the debtor was or is insolvent in the bankruptcy sense. The undisputed evidence before the Commission, and the Commission's findings, show that the debtor was not insolvent.

(b) The total liabilities of the debtor on January 1, 1939, exclusive of the claims of the Corporation and The Western Realty Company, as reported by the Commission in its report of June 21, 1939, approving a modified plan, amounted to \$87,888,660. This amount represents the aggregate of secured claims, and provision for this sum only is made in the Commission Plan. As already stated, no provision of any kind, whether by payment in cash or in allotment of securities, is made for either the unsecured creditors or the stockholders.

(c) The Commission did not in its proceedings make a new determination of the value of the debtor's property under the authority of subdivision (e) of Section 77. It did, however, refer in its report of October 10, 1938 to a final valuation theretofore made by it pursuant to Section 19(a) of the Interstate Commerce Act. Section 19(a) makes such valuation "prima facie evidence of the value of the property \* \* \* in all judicial proceedings brought to \* \* \* set aside \* \* \* in whole or in part any order of the Interstate Commerce Commission." This valuation, with allowance for the net costs of additions and retirements, between valuation dates and December 31, 1935, amounted to \$139,600,455 (230 I. C. C. Rep. 76). Between Jan-

uary 1, 1936 and December 31, 1938 this figure has been increased by the net cost of further additions less retirements. It is not disputed that the original cost of the debtor's property, less depreciation, would amount to more than \$120,000,000. (R. Exh. 29, Statement 16, p. 2; see Op. [899] of Commissioner Miller, Rep. of October 10, 1938, 230 I. C. C. Rep. 108.)

It follows that the report of the Commission itself shows that the debtor's property has a value of many millions of dollars in excess of all claims, secured and unsecured, and that there remains a surplus of value to be applied to the stock of the debtor, and a fortiori to the payment or protection of unsecured claims.

(d) The Commission found (Rep. of October 10, 1938, 230 I. C. C. Rep. 101) that the "equity of the existing stock has no value" and that "the claims of the unsecured creditors, The Western Pacific Railroad Corporation and The Western Realty Company" have no value. It is upon these findings, apparently, that the Commission reached the conclusion that the holders of stock "are not entitled to participate in the plan" and that "no securities or cash should be distributed under the plan in respect of" the claims of unsecured creditors. The Corporation objects to these findings as without support in any evidence before the Commission. It objects, likewise, to the conclusions drawn from those findings as discriminatory, unjust and confiscatory as against the general creditors

and the holder of all the stock, and as not in conformity with the provisions of Section 77 or with the law of the land.

(e) In concluding that the claims of unsecured creditors and the equity of the stock were valueless, the Commission disregarded the valuation which it had made under Section 19(a) of the Interstate Commerce Act, which it apparently adopted in its report in this proceeding. It gave consideration solely to the earnings of the property, allowing no weight to other elements, to which, under subdivision (e) of Section 77, consideration would have been given if value had been separately ascertained in the present proceeding, i. e., all other relevant facts, as well as present cost of reproduction new and less depreciation and original cost of the property and the actual investment therein. Even with respect to "the earning power of the property, past, present and prospective", which is one [900] Element under Section 77(e), the Commission did not comply with the statute. The report shows that the Commission, while purporting to estimate maximum prospective earnings, in reality took past earning history as virtually the only guide or index to value.

Past earnings over a period of years, taken alone, are not a sufficient basis for determining future earnings or value, particularly where, as here, the period considered is abnormal and not fairly indicative of the future because (a) it included years of severe depression affecting railroads as well as

business and industry generally; (b) during these years unusual rehabilitation costs were charged in large part to operating expense, thus distorting the earning picture; and (c) during these years the debtor constructed its Northern California extension at a cost of approximately \$10,000,000. Until this extension was completed and until its contribution of earnings to the debtor's property had become settled and established the future earnings were not fairly indicated by the history of the period considered by the Commission.

(f) Under the Commission Plan all of the common stock authorized is allotted to secured creditors. In so far as this stock represents a value, present or prospective, in excess of the secured claims, such allotment results in transferring from the Corporation and The Western Realty Company, as unsecured creditors, and from the Corporation, as holder of all the stock of the debtor, their respective interests in the property.

(g) The Commission Plan erroneously computes accrued interest due the Reconstruction Finance Corporation at an amount \$176,005 in excess of the true amount due under the agreement between the Reconstruction Finance Corporation and the debtor, as modified by these parties.

(h) For all the reasons hereinabove stated the Commission Plan does not comply with the provisions of Section 77(e) in that it is not "fair and equitable", it does not "afford due recognition to the rights of each class of creditors and stockhold-

ers", and particularly unsecured [901] creditors and stockholders. It "discriminates unfairly in favor of any class of creditors", i. e., in favor of secured creditors.

(i) For all the reasons hereinabove stated the Commission Plan does not conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders. (Section 77(e).)

(j) For the same reasons the Commission Plan is in violation of the law of the land in that it deprives the unsecured creditors and the stockholders of their property without just compensation and without due process of law in violation of the Fifth Amendment of the Constitution of the United States.

V. The "public interest" does not justify the confiscation of property or the transfer of one person's property to another.

Section 77(d) requires that the plan approved by the Commission shall be "compatible with the public interest". Without undertaking here to analyze the attempt of the Commission in its report of October 10, 1938 (230 I. C. C. Rep. p. 87) to interpret and apply this provision, the Corporation urges that the "public interest", however defined, cannot justify the confiscation, without compensation, of the interest of unsecured creditors or stockholders, and the transfer of that interest to secured creditors where the property of the debtor

has a value in excess of the secured claims. (Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 602, 79 L. Ed. 1593, 1611.)

**VI. Amendments to Commission Plan Proposed and Requested by Corporation.**

The Plan can and should be modified so as to give some protection to the unsecured claims and to the stock of the equity, without impairing the prior position of the secured claims. This could be accomplished by allotting to the secured claims, in lieu of the common stock allotted to them under the Commission Plan, additional income bonds and preferred stock in such amounts as would preserve and [902] protect their priorities. Common stock should be issued to the unsecured creditors and to the sole stockholder in such amounts and proportions as may be just. It may be that for some years the earnings will not be such as to permit the disbursement of much or anything in dividends. If, however, the earnings of the railroad should increase so as to give earning power to the common stock, fairness and equity require that the unsecured creditors and the stockholder should have a chance to get some benefit from those earnings after the preferred creditors are fully protected. It is not just, fair or equitable that any such possible or prospective increase over and above the proper protection of their claims should go to the secured creditors to the total exclusion of the general creditors and the stock equity. The suggested modifications

would fully protect the priorities of the secured creditors. Whatever value there would be in the common stock would be subordinate to the securities issued to the secured creditors and would not affect their rights.

The Corporation is not directly concerned with the proportions in which senior securities are allotted to the various secured creditors. That is a question which can best be presented by the secured creditors themselves. Since, however, there is a value over and above the amounts sufficient to satisfy all secured claims, that excess should be capitalized in the form of common stock of no par value and be allotted to the unsecured creditors and the holder of the stock of the debtor.

In order to interfere as little as possible with the Commission Plan, the Corporation suggests that the number of shares of common stock of no par value to be authorized shall be the number provided for in the Commission Plan, i. e., 319,441 shares. The Corporation requests and petitions that the plan be modified:

(a) By allotting to the secured creditors, in lieu of common stock of the reorganized company additional income bonds and preferred stock in such amounts as will fully protect their true claims and priorities, and [903] that the amount of income bonds and preferred stock to be issued be increased accordingly;

(b) That the common stock consisting of 319,441 shares of no par value be allotted as follows:

To The Western Realty Company for its unsecured claim of \$61,667—617 shares of such common stock;

To the Corporation for its unsecured claim of \$7,749,221—77,492 shares of such common stock;

To the Corporation for its holding of \$28,300,000 in preferred stock and \$47,500,000 in common stock of the debtor—the balance of such proposed issue of common stock, amounting to 241,332 shares thereof.

Wherefore, the Corporation respectfully prays that this Court return to the Commission the Commission Plan with the recommendation that it be amended as hereinabove requested, and for such other and further relief as to the Court may seem just and proper.

M. C. SLOSS,

SLOSS, TURNER & FINNEY,

Attorneys for The Western Pacific  
Railroad Corporation. [904]

State of California,

City and County of San Francisco—ss.

M. C. Sloss, being duly sworn, deposes and says that the Western Pacific Railroad Corporation, named in the foregoing document, is a corporation organized under the laws of the State of Delaware, that it has no office and no officer within the State of California; that affiant is an attorney for said

Corporation, that he has been duly authorized to sign and verify the foregoing document on behalf of said Corporation, and that said document entitled "Objections of The Western Pacific Railroad Corporation to Commission Plan of Reorganization, Statement of Claims for Equitable Treatment and Petition for Amendment of Such Plan" is true except as to matters therein stated on information and belief and as to those matters he believes it to be true.

**M. C. SLOSS.**

Subscribed and sworn to before me this 6th day of December, 1939.

(Seal)

**VIOLET NEUENBURG**

Notary Public in and for the City and County of San Francisco, State of California.

My Commission Expires December 31, 1942.

[Endorsed]: Filed Dec. 8, 1939. [905]

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[Title of District Court and Cause.]

**OBJECTIONS OF THE RAILROAD CREDIT CORPORATION TO THE PLAN OF REORGANIZATION CERTIFIED BY THE INTERSTATE COMMERCE COMMISSION, AND STATEMENT OF CLAIM FOR EQUITABLE TREATMENT.**

Now comes The Railroad Credit Corporation, a secured creditor of the Western Pacific Railroad

Company, Debtor, and, pursuant to the Order of this Court dated November 8, 1939, submits its *objections* to the Plan of Reorganization approved by the Interstate Commerce Commission by order dated June 21, 1939, and its *claims* for equitable treatment.

The detailed and specific objections of The Railroad Credit Corporation are that said Plan does not meet the requirements of subsection (e) of Section 77 of the Federal Bankruptcy Act as amended, in that:

1. Said Plan provides for an arbitrary "effective [907] date" that will be at least a year earlier than the actual effective date of a plan of reorganization herein (I. C. C. Order, Par. A), and fails to make adequate provision and adjustments for the application of proceeds and income from collateral security during the interim.

2. The Plan provides for a maximum capitalization that is so low as to be confiscatory, and diverts assets of the Debtor from junior creditors to senior creditors (I. C. C. Order, Pars. B and P-6). This situation is recognized in the Plan itself: the value of new common stock to be issued upon reorganization is treated for most purposes as being \$50 per share (See Item 4, below), but for the purpose of computing capitalization, it is to be taken at \$100 per share (I. C. C. Order, Par. D).

3. The Plan, though providing for a low capitalization, and leaving substantial assets uncapi-

talized, requires the establishment and maintenance of a capital fund, thus diverting income from some creditors, especially the collaterally secured creditors whose status the Plan proposes to change by shifting them in part from a creditor to an equity position (I. C. C. Order, Par. L).

4. The Plan further depreciates the standing accorded by it to existing collaterally secured creditors (a) by diverting income to sinking funds for both the new fixed and income mortgages (I. C. C. Order, Pars. D, J, and L); (b) by providing for the conversion of income bonds into common stock at the rate of 20 shares per \$1,000, principal amount of such bonds (I. C. C. Order, Par. J); (c) by providing that new preferred stock shall share ratably with common stock in dividends declared in excess of 3% upon such common stock, and by other provisions (such [908] as sale price of new stock) of a like effect (I. C. C. Order, Par. M). The effect of such a course upon future financing is obvious.

5. The Plan authorizes 1,000,000 shares of no par common stock, but so restricts the issue thereof that no such stock is to be issued to unsecured creditors (I. C. C. Order, Pars. N and P, and Item 2, *supra*); and further requires that unsecured claims against the Debtor not entitled to priority over the first mortgage shall be canceled (I. C. C. Order, Par. R).

6. The Plan provides that the collaterally secured claim of the Reconstruction Finance Corpo-

ration "shall be provided for under the plan in like securities and in like proportions as those given holders of the debtor's first mortgage bonds" (I. C. C. Order, Pars. O and P). The treatment proposed for the claim of the Reconstruction Finance Corporation is fully justified on the basis of the collateral securing that claim, viz., general mortgage bonds of the Debtor, but not otherwise. The claims of The Railroad Credit Corporation and A. C. James Company, to the extent that they are secured by the same bonds, or equivalent value, are entitled to comparable treatment, but the Plan does not so provide (I. C. C. Order, Par. P). The securities to be issued for new money should stand on their own footing.

7. The Plan provides that the sale of \$10,000,000 principal amount of new first mortgage bonds to Reconstruction Finance Corporation (on account of which Reconstruction is to receive preferential treatment in respect of its existing secured claim), shall be "subject to the approval and authorization of this Commission" (I. C. C. Order, Par. O). By this is meant that the [909] Reconstruction Finance Corporation, even though it is ready and willing to act (and even though said Plan has been assented to by the requisite amount of all affected security holders and has been approved and confirmed by the Court), will not be permitted to purchase said bonds upon any terms at date of reorganization or at any other time unless and until the Commission, in a separate proceeding which may

not be instituted until after final confirmation of the Plan, has approved such purchase by the Reconstruction Finance Corporation upon the record then made before it (I. C. C. Report dated June 21, 1939, sheet 9).

8. The Plan provides that certain collateral pledged by the Debtor as security for notes to the Reconstruction Finance Corporation, The Railroad Credit Corporation, and the A. C. James Company shall, for some undisclosed reason, be reduced to possession by the respective pledgees thereof, and shall be by them surrendered to the reorganized company and canceled, but it provides no machinery for such reduction to possession (I. C. C. Order, Par. R).

9. The Plan modifies in some degree the erroneous allocation of assets of the Debtor as between the first mortgage and the general mortgage (I. C. C. Report dated June 21, 1939, sheet 12), but otherwise perpetuates the error in the earlier report (dated October 10, 1938) wherein the Commission said, "We conclude that, for the purpose of determining the equity of plans of reorganization for the debtor, the lien of the general mortgage, on the Northern California extension and various branches and spurs in question should be considered subject to the lien of the first mortgage. \* \* \*

We consider, for the purposes of a plan of reorganization, that \* \* \* the [910] debtor's equity in that equipment (viz., rolling stock subject to leases, conditional-sale agreements, or equipment-trust

agreements) is subject to the lien of the first mortgage. We consider that the property characterized as non-carrier real-estate is also covered by the lien of the first mortgage. \* \* \* While due recognition must be accorded to the rights of the creditors with whom are pledged general-mortgage bonds, those creditors are not entitled to the same treatment as first-mortgage bondholders, who should be considered as having a first lien upon practically all the assets of the debtor" (I. C. C. Report decided October 10, 1938, sheets 58, 59 and 60). There is necessarily involved in these erroneous conclusions, the erroneous construction placed by the Commission upon certain provisions of the first mortgage, and the effects which were assumed to follow (id. sheets 56, 57).

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Note: The Report of the I. C. C. (dated June 21, 1939) should have stated that the plan proposed by The Railroad Credit Corporation (sheets 2-8) was put forward as a *compromise* plan upon which it was believed that all parties would agree in order to expedite reorganization, and not as a plan which The Railroad Credit Corporation itself believed was fair and equitable from its own standpoint.

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The claims of The Railroad Credit Corporation for equitable treatment are that the Plan should be so modified that:

(a) The Railroad Credit Corporation may be accorded treatment consonant with its status as a secured creditor, [911] and receive new securities representing a fair equivalent of the several items of collateral security pledged with it by the Debtor, or issued or created by the Debtor and pledged with it by third persons.

(b) The Railroad Credit Corporation may not be prejudiced in its holdings of collateral pledged with it by third persons, whether such collateral was issued or created by the Debtor or others; and The Railroad Credit Corporation may not be prejudiced in the application by it of income and proceeds of collateral pending the carrying out of a plan of reorganization herein.

(c) The priority of the general mortgage, as asserted in this proceeding by the Trustee under said mortgage will be recognized, and appropriate adjustments made in the allocation of assets of the Debtor, as between the general mortgage and the first mortgage, and, as a consequence, in the allocation of new securities to the holders of general mortgage and first mortgage bonds, respectively, and also in the allocation of new securities to The Railroad Credit Corporation.

(d) The capital structure will reflect the actual value of the property, regardless of the social or economic desirability of holding back a cushion of uncapitalized, but capitalizable, assets, to the end that the claim of the Western Pacific Railroad Corporation against the Debtor, which The Railroad

Credit Corporation holds in pledge, may duly share in the distribution of the assets of the Debtor upon reorganization.

(e) The income of the reorganized company may not be unduly diverted for the benefit of some creditors, to the prejudice of other creditors, whether by the establishment of unnecessary capital or sinking funds, or otherwise. [912]

Wherefore, The Railroad Credit Corporation prays that the Plan of Reorganization, as certified to the Court by the Interstate Commerce Commission, shall be disapproved and referred back to said Commission for further action in accordance with the provisions of Section 77 of the Federal Bankruptcy Act as amended, so as to give due effect to the rights and interests of The Railroad Credit Corporation as the same may be finally determined and decreed.

Respectfully submitted,

THE RAILROAD CREDIT  
CORPORATION.

By D. WILLARD, JR.

Vice-president and General Counsel.

Baltimore, Md.,

December 4, 1939.

[Endorsed]: Filed Dec. 6, 1939. [913]

